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SUBMISSION

By

THE GOVERNMENT OF THE PROVINCE OF ALBERTA

Concerning

THE GOVERNMENT OF CANADA

WHITE PAPER

Entitled

"PROPOSALS FOR TAX REFORM"

JUNE 1970

Printed by L. S. WALL, Queen's Printer
EDMONTON, Alberta

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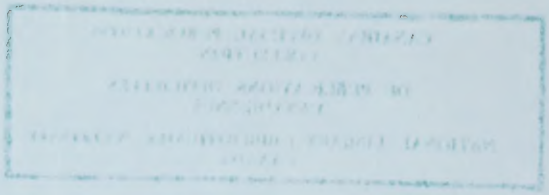

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PART 1

STATEMENT BY ALBERTA

FEBRUARY, 1970

Meeting of the Tax Structure Committee,
Quebec City, February 2nd and 3rd, 1970

STATEMENT BY ALBERTA

Introduction

1. The Tax Structure Committee was established at a Federal Provincial Conference in Quebec City in 1964 to make studies and submit recommendations concerning Federal-Provincial fiscal arrangements for the five year period 1967-72.

2. At the first meeting of the Committee held in Ottawa on October 13th, 1964, the then Minister of Finance outlined the objectives which the Federal Government had in mind in proposing the Committee and estimated that about fifteen months would be required to complete its work.

3. Over five years have now elapsed since the Committee commenced its task and progress is coming to grips with revision of the income tax system, and towards reaching broad general agreement with respect to Federal-Provincial fiscal arrangements for a further period of time has been very slow. During the past five years major changes have occurred in social and economic conditions throughout Canada and the financial operations of all levels of government in the country have expanded at a record breaking pace from year to year. In Alberta the annual Provincial budget has doubled during this period and the combined annual budgets of local governments in the Province have similarly increased. Surely there need be no further delay in making a concentrated effort to finalize mutually acceptable fiscal arrangements between the Federal Government and the Provinces and to stabilize these arrangements for a further specified period of years commencing in the near future.

Equalization Grant Formula and The Estate Tax

4. Since 1964 equalization grants and the estate tax have been revised by action of the Federal Government and Parliament. While the Government of Alberta subscribes to the principle of equalization we believe that the present formula used to pay equalization grants is loaded against Alberta. It appears to us, however, that for the present at least the Federal Government is fully committed to this distorted formula. With respect to the estate tax Alberta takes the position that this form of taxation should be abolished everywhere in Canada except for very large estates. Since April 1st, 1967, we have been rebating to eligible estates the full amount of Alberta's 75% share of this tax.

Shared Tax Fields and Shared Cost Programs

5. Alberta wishes to reserve the right to make further submissions on future occasions regarding both the equalization grant formula and the estate tax but at this meeting we shall devote our presentation in the main to a statement of our position with respect to sharing the income tax field and shared cost programs.

6. For nearly thirty years the Federal Government and the Provinces have been sharing revenues from the income tax field pursuant to a succession of agreements. During the same period shared cost programs have increased dramatically in the social service fields of health, education and welfare to the point where the Federal Government now plays a dominant role in discharging responsibilities which by the constitution are assigned to the Provinces. Provincial programs are subject to Federal supervision in order to qualify for reimbursement. A number of these programs were instigated by the Federal Government and the Provinces had no real choice except to participate even though they might not agree with the order of priority of the program or to some of the terms and conditions prescribed by the Federal Government.

7. The Constitutional Conference recognized the priority to be accorded the study of the distribution of powers, in particular the taxing and spending powers, and directed that the Tax Structure Committee should be reconvened for the purpose of examining and reporting at the earliest opportunity to First Ministers, on:

(i) The occupancy of available tax field by each of the Provincial Governments and the Government of Canada, and

(ii) Federal-Provincial shared cost program arrangements.

To this end the Continuing Committee of Officials on Fiscal and Economic Matters as instructed by the Tax Structure Committee have undertaken and completed fiscal review and outlook studies for the period 1952 to 1971. The projections contained in these studies forecast a surplus position for the Federal Government commencing in 1969 and continuing through to the end of the forecast period and an alarming acceleration of a deficit position for the Provinces and Municipalities through the same period. These studies confirmed trends shown in like studies made by the Tax Structure Committee in 1966, i.e. an improving Federal Government position through the projection period as compared with a rapidly deteriorating position for the Provinces and Municipalities.

In the forecast period 1969-70 to 1971-72 the projections show a substantial net surplus position for the Federal Government as compared with a deficit position for Provincial and Municipal governments which almost doubles from 1969-70 to 1971-72 to the staggering amount of two billion dollars. This results, of course, from a sharp reduction in expenditure growth at the Federal level accompanied by tax increases as provided in the 1968 and 1969 budgets as opposed to Provincial and Municipal expenditure growth trends which far outpace revenue patterns.

8. Alberta is convinced that these circumstances and developments provide ample evidence of the need to conduct a realistic review of Federal-Provincial fiscal relations. Alberta takes the position that the Provinces should have full freedom to carry out their constitutional responsibilities without domination or supervision by the Federal Government and must be given sufficient taxing room so that an undue burden of taxation is not imposed on the people. To achieve this objective shared-cost agreements should be terminated at the earliest possible time, and the Provinces should have access to a portion of the direct income tax field large enough not only to finance these responsibilities in full but also to reverse the projected deficit trend in the financial position of Provinces and Municipalities. Clearly there is an immediate need for redistribution of the revenue resources available to governments in order that each jurisdiction might realistically be in a position to discharge its responsibilities. While many problems

remain to be resolved through discussions and decisions to be taken in the Constitutional Conference, action to correct the existing imbalance must be taken now.

9. Alberta is prepared to assume full financial responsibility for all existing shared cost programs and to relinquish completely all Federal Government transfer payments in connection with these programs in exchange for withdrawal by the Federal Government from portions of the income tax fields sufficient to give the Provinces the taxing room necessary to assume this full measure of responsibility and to offset the growing deficit trend.

White Paper on Tax Reform

10. With respect to the Federal Proposals for Tax Reform contained in the White Paper issued last November Alberta is preparing a comprehensive submission setting forth our views regarding the impact of these proposals on the economy of the nation and the province with specific attention to the proposals for:

1. New tax treatment for the extractive industries.
2. Incidence of taxation on small businesses.
3. A capital gains tax—
   (a) the tax rate
   (b) its application to private residences
   (c) taxation at five-year intervals on gains accrued but not realized with respect to shares of widely held corporations.
4. Treatment of interest and dividends to the detriment of the capital bond market.
5. Tax treatment for shareholders of public utilities companies.

11. Alberta's submission will be made to the Minister of Finance. In view of the hearings of the Parliamentary Committee in connection with the White Paper on Tax Reform which we understand have now begun we would appreciate some indication from the Minister as to what he considers a reasonable deadline for the presentation of briefs by the Provinces.

PART 2

SUBMISSION BY THE

GOVERNMENT OF THE PROVINCE OF ALBERTA

CONCERNING THE GOVERNMENT OF CANADA

WHITE PAPER ENTITLED

"PROPOSALS FOR TAX REFORM"

JUNE, 1970

SUBMISSIONS

By

THE GOVERNMENT
OF THE
PROVINCE OF ALBERTA

Concerning

THE GOVERNMENT OF CANADA

WHITE PAPER

Entitled

"PROPOSALS FOR TAX REFORM"

(And Revisions Thereto)

Printed by L. S. WALL, Queen's Printer
EDMONTON, Alberta

June 1, 1970

The Honourable E. J. Benson,
Minister of Finance,
Government of Canada,
OTTAWA, Ontario.

Dear Mr. Benson:

The attached brief presents the results of a comprehensive study undertaken by the Government of Alberta concerning the Federal Government White Paper entitled "Proposals For Tax Reform."

An understanding of the great importance of certain natural resources to the economic growth of Alberta is necessary in order to appreciate the impact which the proposed White Paper taxation system would have on the future development of our province and the well-being of our citizens. In the interests of brevity, this type of background information has been kept to a minimum in this present submission. However, the subject was discussed in detail in our 1967 submission in response to the Report of the Royal Commission on Taxation.

Chapters II, III, IV V, and VI of our present submission deal with those chapters in the White Paper which are of major concern to the Government of Alberta, as is shown in the attached Table of Contents. Our reaction to the White Paper section dealing with the subject "Co-ordination with the Provinces," has been treated in a separate brief which I presented to you at a meeting of Ministers of Finance and Provincial Treasurers in Quebec City in early February this year.

Chapters VII, and VIII respectively, deal with specific impacts which we believe the proposed White Paper taxation system would have on agriculture and the petroleum industry in Alberta.

Chapter IX summarizes our reaction to the aims of tax reform as enunciated in the White Paper and to the apparent social, economic, and political philosophy of the authors of the White Paper. We cannot believe that the philosophy of the White Paper truly represents and reflects the philosophy of the Government of Canada. Certainly it differs greatly from the philosophy of the Government of Alberta.

A concise summary of our submission is contained in Chapter I.

Although the White Paper is restricted to the subject of tax reform, it cannot be divorced from interrelated subjects such as the recently amended

Estate and Gift Tax Act. Our submission discusses the serious impact which these amendments and a capital gains tax such as that proposed in the White Paper would have on Canadian taxpayers.

With respect to estate taxes, the rebate by the Province of Alberta of its portion of estate taxes to beneficiaries should not be treated as taxable income or as capital gains in any revised tax legislation. We would appreciate receiving your confirmation of this understanding at an early date.

We would also like to emphasize the concern of the Government of Alberta concerning recent actions by the Federal Government which, in addition to the White Paper, have created a serious cloud of uncertainty for both domestic and foreign investors. We refer specifically to the revocation of oil and gas regulations relating to the North, a recent speech inferring a shift in Canadian policy towards foreign capital, and other actions which have occurred with little if any advance notification to companies or provincial governments affected. Such actions could very easily prevent Canada from obtaining the necessary level of investment funds for the petroleum and other resource industries to maintain a satisfactory rate of economic growth.

In your maiden speech in the House of Commons on October 23, 1962, you recognized the need for tax concessions and real incentives, and for bold changes in monetary and fiscal policy, including taxation, in order to speed up Canada's economic growth. Since your specific reference then was to concessions and incentives in areas where there was chronic unemployment, we are confident that you would not now wish to see the removal of present incentives which would discourage economic growth and development and create more unemployment.

The Government of Alberta recognizes the need to revise our tax legislation in Canada from time to time. Indeed we support a number of the White Paper proposals for tax reform. However, we cannot support many of the major untested proposals in the White Paper since we do not believe that their implementation would be in the best interests of Canada and Canadians.

Yours sincerely,
ANDERS O. AALBORG.

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Chapter I

SUMMARY

THE INDIVIDUAL AND FAMILY IN TAXATION (Chaper II)

1. The Government of Alberta **supports** the following tax proposals in principle:

(a) deduction of child care expenses for working mothers;

(b) deduction of employment expenses;

(c) increased exemptions for incapacitated citizens with low incomes;

(d) removal of tax exemption status on salaries of visiting professors and teachers; and,

(e) taxation of members of the armed services on the same basis as other Canadians.

2. The Government of Alberta does **not support** the proposal to eliminate the tax exemptions relating to all fellowships, scholarships, bursaries and research grants.

3. The Government is concerned that the proposed changes in the tax treatment of pension and retirement savings plans will adversely affect some present and future participants.

4. The Government supports the White Paper objective to reduce the financial burden of low-income Canadians, but prefers to reach this objective by supporting tax systems which encourage economic growth through tax incentives.

CAPITAL GAINS AS INCOME (Chapter III)

1. The Government of Alberta rejects the specific White Paper proposal to tax capital gains for the following reasons:

(a) the proposal does not recognize that a fair and equitable taxation system must provide tax incentives as rewards for risk taking;

(b) the capital gain would be taxed at the marginal rate of the taxpayer, which will tend to discourage investment in the comparatively high risk petroleum industry. Investors in that industry are motivated by prospects for capital gains rather than dividends.

(c) the combined effect of the capital gains tax proposal and existing estate and gift tax legislation will tend to break up pools of private investment capital and shift this capital from the private to public sector which we feel is unnecessary and undesirable.

(d) the valuation day and five-year "deemed realization" concepts could upset investment patterns and would create serious administrative problems;

(e) the proposal to tax capital gains on principal residences would be discriminatory, could affect most homeowners, would force Canadians to lose their freedom of choice of type and location of residence, and would be unfair to many Canadians subject to frequent transfer;

(f) the revenues expected to be realized by the government from implementation of the White Paper capital gains tax proposal are comparatively small;

(g) it makes no allowance for exemptions of gains caused by inflation.

2. The Government of Alberta maintains the position stated in our 1967 brief in reply to the Carter Commission Report. It would be imprudent to introduce a capital gains tax in Canada, which is chronically short of investment capital.

CORPORATIONS AND THEIR SHAREHOLDERS (Chapter IV)

A. Proposed Creditable Tax System

1. The White Paper proposes to establish one set of rules for taxation of closely-held corporations and a different set for widely-held corporations. One of the two basic assumptions for these differentiations is wrong and, therefore, the proposal must be seriously re-examined. The erroneous assumption is that, by and large, closely-held companies compete with proprietorships, partnerships, and other closely-held corporations, and widely-held or public companies compete with other public corporations.

2. The low creditable tax position of many petroleum companies under the proposed White Paper system would discourage Canadians from investing in that industry, and would divert their investments to high tax-paying, high-dividend industries.

3. At the same time, increased foreign ownership would be encouraged because the disincentives to Canadian shareholder interests would cause market values of these companies to decline, as would the 2½-year limit on the payment of cash dividends.

4. The proposed White Paper system would aggravate the investment climate for fixed income securities, which is so important to the Federal and Provincial governments, because equities will be more attractive and because of full taxation of gains on bonds and mortgages.

5. For these reasons, the proposed creditable tax system should be rejected and present dividend tax credit should be retained with some modifications.

B. Impact of Proposals on Small Businesses

1. Elimination of the low corporate tax rate would adversely influence the operations of a significant number of small Alberta corporations.

2. The present taxation system has some weaknesses but they are not considered too significant when weighed against the serious impact the proposed system would have on small corporations.

3. The White Paper acknowledged that its proposed system would substantially increase the taxes borne by existing small corporations, but failed to deal with the seriousness of this problem. Removal of the lower rate would increase the tax liability of a company with an annual taxable income of $35,000 by $10,000 per year or an increase of 140 per cent. Increased taxation would reduce the cash inflow available to small corporations to meet financial commitments.

4. The present low corporate rate must be retained until an equally or more effective incentive system can be developed.

C. Proposed Tax of Investor-Owned Utilities

1. Since 1966, the Federal Government has turned over 95 per cent of the corporation tax collected from utilities to the provincial governments. This arrangement was made to remove the tax differential between investor-owned and government-owned utilities. Alberta has passed these rebates on to utility consumers.

2. The proposed White Paper system would not give shareholders of utilities credit for taxes rebated to the provincial governments. Investment in such shares by Canadians would be much less desirable and as a result:

(a) would increase the cost of financing expansion of utility operations. and therefore utility rates to consumers; and,

(b) would increase the attractiveness of Canadian utility shares to foreign investors who would be unaffected by this White Paper proposal, thus imposing a definite and serious threat to Canadian control of a vital industry.

3. The Government of Alberta holds that shareholders of investor-owned utilities should be treated in the same manner as shareholders of other corporations (see page IV-18).

BUSINESS AND PROPERTY INCOME AND TAXING INTERNATIONAL INCOME (Chapter V)

1. We support in principle the White Paper objective to eliminate indiscriminate 'expense account' living. However, the White Paper proposal is too inflexible and impractical. In our opinion, indiscrimnate 'expense account' living should be minimized through administration of the law.

2. The proposal to treat certain types of trusts as corporations or mutual funds should be amended so as to prevent hardships for many legitimate trusts. Once again, tax abuses should be minimized through administration of the Act.

3. Those companies that heeded the request of our Federal Government to let Canadians participate in operations of foreign companies in Canada, would be subject to the five-year deemed realization under the White Paper system. Implementation of such a proposal would discourage other foreign companies from issuing shares in Canada.

Also, the proposal to eliminate depletion on royalty interest would reduce the return on foreign capital invested in the Canadian petroleum industry, and therefore make this type of investment in Canada less attractive.

IMPACT ON REVENUES AND THE ECONOMY (Chapter VI)

1. The White Paper revenue estimates erroneously assume that economic activity will not change significantly if its taxation system is introduced. As shown in Chapter VIII, petroleum industry investment and therefore Alberta Government revenues would be adversely affected under the White Paper system.

2. The White Paper states that on the whole the balance of payments should be modestly improved under its system. In our opinion, reduction of foreign investment in the petroleum industry would; (i) reduce capital inflows; (ii) reduce the value of net exports of hydrocarbons because of

reduced investment and therefore lower reserve additions; and, (iii) increase capital outflows due to repatriation of foreign investment capital.

3. Reduction of foreign investment in the Canadian petroleum industry caused by implementation of the White Paper proposals would tend to increase unemployment in Alberta, affecting a cross-section of the Alberta labour force. Such a development obviously would be undesirable, particularly in view of the comparatively fast growing labour force in Alberta.

4. The White Paper admits that the hazards of forecasting are increased when major changes for the tax structure are proposed. This admission is not re-assuring. Because our own analysis indicates that the proposed system would have an adverse effect on our provincial economy, we cannot support the major proposals as a package.

THE IMPACT OF THE WHITE PAPER PROPOSALS, IF IMPLEMENTED, ON AGRICULTURE IN ALBERTA (Chapter VII)

1. The problems facing the Western Canadian farmer and rancher have been well publicized. Implementation of the White Paper proposals would add to these problems as a result of increased taxes arising from (i) abolition of the basic herd concept, (ii) the capital gains realized on the sale of farming units upon retirement, (iii) disposal of fixed assets which previously created a non-taxable gain, (iv) the gains from any sale of mineral rights, and, (v) increased personal tax rates.

2. The Government of Alberta recommends that:

(a) Since the capital gains from the sale of farm units represents a high degree of inflation rather than a gain in real dollars, such gains should be tax-exempt. The combined effect of the proposed capital gains tax and amended estate and gift taxes would destroy family farm and ranch units, and tend to transfer ownership of some units to foreign investors;

(b) the 'basic herd' concept should be retained and capital gains therefrom should not be taxed;

(c) the straight line basis of capital cost allowance should be continued and any gain therefrom should bear no tax; and,

(d) farmers and ranchers should be permitted a special allowance by gift or bequest of $50,000 per child, with no tax when the gift is in the form of a farm unit or part of a farm unit, such allowance to be subject to periodic review.

IMPACT OF THE WHITE PAPER RECOMMENDATIONS ON THE ALBERTA PETROLEUM INDUSTRY AND ON THE FISCAL CAPACITY OF THE PROVINCE OF ALBERTA (Chapter VIII)

1. The petroleum industry accounted for over 30 per cent of the Province's total net value of production by primary industries in 1969. The industry has also been the major source of direct revenue for the Government of Alberta, to the extent of $270 million or 37 per cent of the total net general revenue.

2. It is obviously desirable to preserve the economic stability of the petroleum industry. Alberta's economic growth in recent years has relieved the Federal Government of certain regional responsibilities and reduced the

overall burden of the Canadian taxpayer. Regardless of whether this relatively low level of financial dependence on the Federal Government can be maintained, Alberta's requirements can be minimized by preserving the stability of our basic industries.

3. The Government of Alberta recommends that:

(a) the proposed "principal business test" related to exploration and development costs should be abandoned;

(b) the proposed depletion allowance for operators should be abandoned in favour of a gross depletion allowance;

(c) the proposal to repeal the present 25 per cent depletion allowance for non-operated production for royalty income should be abandoned; and,

(d) the proposal to drop the three-year exemption for new mines should be re-examined in order that development of the Athabasca Oil Sands and other mining ventures can be encouraged.

4. The Government of Alberta is deeply concerned over the outlook for its future revenues in relation to anticipated expenditures should the White Paper proposals be adopted. A deficit of $113 million is estimated for the current fiscal year. Implementation of the proposals will further reduce the fiscal capacity of the Government of Alberta.

5. Potential investment in the conventional segment of the industry could be reduced by at least 10 to 25 per cent or by at least $1.0 to $2.5 billion between 1970 and 1980. In addition potential investments of $250 million to $600 million in further development of the Athabasca Oil Sands could be withdrawn.

6. If implementation of the proposed tax reforms reduces investment to this extent, the Government of Alberta would lose between $600 million and $1 billion of potential revenue from the petroleum industry between 1970 and 1980.

ASSESSMENT OF THE APPARENT WHITE PAPER OBJECTIVES AND PHILOSOPHY (Chapter IX)

1. One of the White Paper objectives is to provide tax relief to the lower income segment of our economy by eliminating or reducing their tax burden and increasing the tax burden of others, particularly those in the upper end of the $5,000 to $10,000 range. However, while we agree with this objective in principle, we believe that it is preferable to achieve it through implementation of policies designed to maximize economic growth rather than to stress redistribution of the tax burden.

2. In order to bring forth the investment capital required during the next decade and, at the same time, to encourage Canadians to take a greater investment role in developing our resources, they must be given tangible tax incentives to compensate for investments in high-risk natural resource industries. The White Paper concept of fairness does not recognize the need for such incentives. Our resource industries are financed largely from reinvestment of earnings. Therefore, prospective capital gains are more important to investors than dividends.

3. The White Paper states that the needs of various governments to do useful and important things are so great that we cannot afford to reduce

the overall revenues from personal and corporate income tax. The Government of Alberta cannot support the introduction of a completely new tax system which will generate incremental revenues for new social programs that have not been identified by the Federal Government nor approved by the Canadian public.

4. The effect of many White Paper proposals will be a further shift of capital from the private to the public sector in Canada. The Federal Government has expressed a desire to increase Canadian ownership of our economy. If the Government means ownership by the private sector, we support this objective. However, in view of the apparent intention to increase the relative importance of the public sector, we wonder if the Federal Government is proposing increased Canadian ownership through Government agencies. We would not support such a policy.

5. We do not believe that the introduction of the basic new tax system as proposed is either advisable or necessary. Unfortunately, because many of the major proposals are inter-dependent, it is impossible to make changes without rendering the whole package obsolete.

The Government of Alberta recognizes that tax reforms must be introduced from time to time in order to take into account the dynamic nature of our society and, therefore, is prepared to support gradual introduction of reasonable tax reform measures. However, it is not prepared to accept the replacement of the existing Act with totally new and untested tax reform measures. It would be irresponsible to support the latter approach when its impact on the Canadian economy and therefore on the welfare of each Canadian citizen is unknown and cannot be measured with a reasonable degree of reliability.

Chapter II

THE INDIVIDUAL AND FAMILY IN TAX REFORM

The primary purpose of this Chapter is to comment briefly on White Paper proposals relating to the individual and family which the Government of Alberta supports or does not support. Specific reference is made to those proposals dealing with pension plans, retirement savings plans, and general income-averaging options. Reference is also made to the generalized and undocumented nature of certain statements which presumably form the basis for these proposals, and to the suggestion that additional reforms may be forthcoming.

A. PROPOSALS WHICH THE GOVERNMENT OF ALBERTA SUPPORTS

1. Personal Exemptions

We support in principle the White Paper objective to reduce the financial burden on low-income Canadians. Increased personal exemption or a system of tax credits are alternative ways in which some relief can be achieved.[1] However, as pointed out later in this Chapter, we are concerned that the discussion of personal exemptions in paragraph 2.3 of the White Paper is misleading.

2. Child Care Expenses

We also support this proposal which is an incentive for mothers to work, thereby providing them with an opportunity to improve the standard of living of their respective families.

3. Employment Expenses

We also support this proposal in principle. However, we believe that the proposal regarding "expense account living" is discriminatory and impractical. This subject is discussed in more detail in Chapter V.

We agree that unemployment contributions should be deductible for tax purposes and that unemployment insurance benefits should be taxable.

4. Exemptions for Incapacitated Citizens

The proposal to assist the incapacitated and the elderly is commendable. However, an additional exemption of $500 may not create a tangible benefit to incapacitated citizens with low incomes. Also, the proposal refers specifically to persons over 70, the blind, or persons confined to a wheelchair. There will be other citizens who may be incapacitated for different reasons and the Federal Government should take this factor into account.

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[1] This subject is treated in some detail in a paper entitled "The Effect of Tax Rates on the Impact of Tax Reform: The White Paper Versus An Alternative", presented to the Canadian Tax Foundation Conference in Montreal on March 23, 1970, by Professor John Bossons, visiting Professor of Economics, Yale University.

5. **Tax Exemption of Visiting Professors and Teachers**

The two-year exemption from Canadian income tax on the teaching salaries of visiting professors and teachers should be removed, particularly since in some circumstances they have not been taxed in the country where they normally reside.

6. **Tax Benefits of Members of the Armed Services**

Members of the armed forces should be taxed on the same basis as other Canadians, thereby removing special benefits which they presently enjoy.

B. PROPOSALS NOT SUPPORTED BY THE GOVERNMENT OF ALBERTA

1. **Removal of Exemptions on Fellowships and Scholarships**

Paragraph 2.24 outlines the basis for eliminating the tax exemption relating to most fellowships, scholarships, bursaries and research grants not related to services. Irrespective of the White Paper's explanation for removing these exemptions, we believe that under certain circumstances exemptions are warranted.

The Government of Alberta is very active in the field of scholarships, bursaries and educational grants. If recipients of such financial assistance are required to pay tax, the Government of Alberta will be obligated to increase the level of assistance in order for the student to be in the same cash postition. Such an increase would represent a transfer of funds from the Alberta to the Federal Government treasury.

C. PENSION PLANS AND RETIREMENT SAVINGS PLANS

The Government of Alberta is concerned that the proposed changes in the tax treatment of such plans will adversely affect Canadians who at present or in the future are participants. For example, the proposal to levy taxes on savings withdrawn from such plans at ordinary rates will discourage Canadians from attempting to provide for their retirement.

The present provision, which allows such payments to be taxed on the basis of average rates of tax paid in the three previous years or, in the case of death benefits, at a flat rate of 15 per cent, makes much more sense. The White Paper suggestion that these taxes can be deferred by transferring the amount to a registered retirement savings plan in the name of the widow is too inflexible. In many instances the widow's need is for cash rather than an annuity.

Under the White Paper taxation system, these plans would have to invest no more than 10 per cent of their assets in foreign securities or investments in order to qualify for tax-free status. Since there can be no guarantee that Canadian securities or investments will be more attractive than their foreign counterparts in the long-run, this provision is too restrictive.

D. GENERAL INCOME-AVERAGING OPTION

Paragraph 2.56 of the White Paper points out that:

"the formula is necessarily complicated but this would not concern taxpayers because it can be applied on their behalf."

This fact would be unsatisfactory to many taxpayers who are eligible to use income-averaging provisions. Also, the admission that the formula is complicated seems inconsistent with the overall White Paper objective that:

"the system must be simple enough for the taxpayer to understand . . ."

E. GENERALIZED AND UNDOCUMENTED STATEMENTS

The section of the White Paper dealing with taxation of the individual and family, and indeed later sections, include many opinions, assumptions or generalized and undocumented statements. In our opinion, some of these statements are misleading. This does not necessarily means that the Government of Alberta disagrees with the basic ideas set forth. However, certain proposals lack the degree of documentation which we would have expected. Statements falling into this category include:

1. Paragraph 2.3 states that basic exemptions in Canada continue to exceed those of other comparable countries such as the U.S.A. This is a misleading statement. As the authors of the White Paper well know, the basic exemption allowed is only one factor to be considered when comparing personal income tax levels in different countries. A proper comparison can only be made by studying salary or wages for comparable work and the total, not just basic, exemptions permitted. It is indeed unfortunate that the White Paper gave so much prominence to such a misleading statement.

2. The White Paper should have provided more information on the composition of the 750,000 taxpayers to be removed from the tax rolls and the 3,000,000 additional taxpayers at the lower end of the income scale whose taxes would be reduced under the White Paper system. For example, how many are part-time student workers or married women leaving the work force during a taxation year, and what would be the average tax reduction per taxpayer in these groups? Such information would place us in a much better position to assess the White Paper proposals vis-a-vis other direct or indirect alternatives which would have the effect of improving the well-being of low-income Canadians. In our opinion, incentive legislation designed to stimulate the economy would be of greater benefit to the low-income groups. Being placed in a somewhat lower tax position, as proposed under the White Paper system, would be of little benefit to low-income groups if they lose employment as a result of a slowdown in economic activity caused by introduction of the White Paper system.

3. The White Paper proposal to allow child care expenses states:

> "while it is not possible to make an accurate forecast of the number who would benefit from this new deduction, it seems likely to be several hundred thousand families."

Because of its access to tax, unemployment and employment records, the Federal Government should be in a position to provide a more precise estimate. If the number of families that would benefit from this proposal turned out to be 10,000, then certainly the proposal should be considered in a different way.

4. According to the White Paper, the proposed change in basic exemptions would reduce taxes substantially on those with higher incomes, unless offset by rate changes. It points out that the saving to a high-income person would be $659 and to a low-income person $118. The $659 figure reflects the saving to a taxpayer in the 82.5 per cent bracket. Therefore, in view of the relatively small number of Canadian taxpayers in this category, the comparison is misleading.

5. The White Paper makes frequent references to 'loopholes' in the Act. We would be interested in knowing what specific loopholes exist in the Present Act which cannot be or have not been blocked by changes in that Act or by more stringent enforcement by the Administration.

F. IMPLICATIONS THAT OTHER REFORMS MAY COME LATER

The White Paper rejected the family unit concept as part of its proposed tax system. However, the White Paper also indicated that after its basic reform proposals are in effect a family unit basis or more complicated system could be considered as a further installment of tax reform.

The White Paper also states that any action regarding deductions for dependants should be related to the further evolution of Canada's social security and social development programs, which implies that other tax reform measures, and increased taxation to cover the costs of such programs, may be proposed at a later date.

These statements contradict the position outlined in paragraph 1.12 of the White Paper to the effect that:

> "The present reform of the income tax should produce a reasonably stable system which can develop, but which need not be fundamentally revised for a considerable period."

We agree entirely with the latter part of paragraph 1.12 that repeated changes, particularly in the basic structure of the tax system would bring apprehension.

Chapter III

CAPITAL GAINS AS INCOME

The purpose of this Chapter is to indicate the position of the Government of Alberta to (i) the principle of taxing capital gains as income, and, (ii) the specific White Paper proposals to tax such gains. Major subjects discussed include: the White Paper rationale for taxing capital gains; the proposals concerning valuation day and deemed realizations; the proposal to tax capital gains realized on the sale of principal residences; the combined effect of the proposed capital gains tax and taxation of gifts and bequests; the impact of the proposals on emigration and immigration; the relative importance of capital gains tax as a source of government revenues; and, the position of the Government of Alberta concerning taxation of capital gains.

A. WHITE PAPER RATIONALE FOR TAXING CAPITAL GAINS

The White Paper takes the position that capital gains must be taxed if Canada's tax system is to be fair and effective, and cites several examples to show how little difference there is between many capital gains and taxable income. As stated in paragraph 3.6, "The form of the transactions differs, but the nature of the income does not."

We agree that in many cases the distinction between capital gains and income is difficult to assess. However, there are other factors which must be considered, including the need for tax incentives if we are to attract new investment capital and services into our economy. In order for a tax system to be fair, it must provide tax incentives in order that unequals are not taxed as equals. Since the subject of fairness and equity is discussed in detail in Chapter IX, it is only necessary at this point to indicate that the White Paper definition of fairness and equity excludes any recognition for risk-taking.

B. THE WHITE PAPER PROPOSAL TO TAX CAPITAL GAINS AS INCOME

Under the proposed White Paper tax system, capital gains would be subjected to a progressive tax as part of the general income tax. Taxable gains would be taxed and capital losses would be deductible at the marginal rate of the taxpayer. The White Paper holds that taxation of gains would be partially offset by a reduction in existing personal tax rates to 50 per cent and by the proposed income-averaging provisions.

The reduction to a maximum personal tax rate of 50 per cent will be of no benefit, however, to investors whose total taxable income is under $24,000, the level at which the 50 per cent rate is reached under the White Paper system. Also, the ability to write off capital losses will be of little benefit to small businessmen who are dependent on a single source of income.

The general income-averaging provision would be of little benefit, particularly since it would not be effective for five years.

As pointed out in Chapters VII and VIII of this brief, growth of the agricultural and petroleum industries is largely dependent on reinvestment

of retained earnings. For these reasons, we are concerned that the implementation of the White Paper proposals for taxation of capital gains would have a detrimental effect on future development of Alberta and other resources-based provinces. Our feelings are similar to those reflected in a recent speech by Mr. R. D. Brown to the Canadian Tax Foundation,[1] an excerpt from which is shown below:

> "There are large numbers of people who believe, sometimes for ill-articulated reasons, that capital gains should not be taxed quite like income, that they are somehow of a different character. Disregarding the more self-seeking arguments put forward by this group, the germ of truth that remains is that a heavy taxation of capital gains hinders the accumulation of private capital, and growth in the private sector of the economy. It makes the economy more reliant on the government's sector and government spending, and this in turn has a number of effects which many people (including myself) find at least mildly distressing. Furthermore, the taxation of long term capital gains at full tax rates imposes a far heavier burden than is justified on such profits, primarily because the amount of the profit has been overstated because of the influence of inflation."

1. Valuation Day

Paragraphs 3.15 and 3.16 outline the basis for establishing valuation day. Only gains accrued after that day would be subject to capital gains under the White Paper. We recognize that, if a capital gains tax is introduced, there will have to be a clear-cut basis for putting a value on assets at the start of the system. We believe that the valuation day basis outlined in the White Paper has a number of inherent problems, some of which are identified below:

(a) The investor who has a capital loss on paper as of valuation day would be placed in an unfair position. It has been suggested by others that this problem could be resolved by adopting a cost or market basis for valuing assets on valuation day;

(b) Preparing realistic valuations, particularly for shares in private companies, is a highly specialized, costly and time-consuming procedure. Valuation costs incurred by corporate or private taxpayers should be a tax deductible item or should be added to the valuation base of the assets;

(c) Although it will not be a requirement that the actual valuation be determined on or close to the valuation day declared by the Minister of Finance, a valuation as at valuation day must be available when the assets are sold. Unless the taxpayer determines and records such a value close to valuation day, he may find it extremely difficult at a later date to prepare a value as at valuation day; and,

(d) The Minister of Finance has indicated[2] that any reasonable value which an owner established for his residence would be accepted by the Revenue Department. Presumably the Minister will hold the same position concerning valuations established for private companies and

[1] "Problems in the Timing and Measurement of Capital Gains" by R. D. Brown, F.C.A., Price, Waterhouse & Company, Toronto, presented to the Canadian Tax Foundation Conference in Montreal on March 23, 1970.

[2] In an address to the 48th Annual Conference of the Ontario Association of Real Estate Boards, Chateau Laurier Hotel, Ottawa, March 16, 1970.

other assets. It is our understanding that, since the introduction of a capital gains tax in the United Kingdom in 1965, a very sizable backlog of litigation has developed between taxpayers and the Revenue Department concerning valuation matters.

These four examples illustrate the practical difficulties which will arise if the White Paper 'valuation day' proposal is implemented. Before such a proposal could be accepted, evidence should be provided to show that these and other problems can be, and would be, resolved with a minimum of dislocation and needless frustration to taxpayers in the management of their affairs.

2. Deemed Realizations

Under the proposed White Paper system, shareholders of widely-held corporations would be required to revalue their shares to market every five years and take one-half of the resulting gain or loss into account for tax purposes in that year. In other words, the 'paper' gain would be taxed even though the taxpayer had not realized an actual gain through sale of shares.

The five-year revaluation proposal was made on the grounds that: it would reduce the 'lock-in' effect that might otherwise occur as a result of a capital gains tax based on realization (since taxpayers would be unwilling to sell shares because of the tax cost); it would enable the government to classify more reorganizations and mergers as tax-free transactions; and, it would reduce the tax postponement which would otherwise result where the lack of marketability of the asset made the treatment compelling, for example, at death.

A supplementary Paper (70-31) dealing with the proposed periodic revaluation of shares in widely-held companies was released by the Department of Finance on March 10, 1970. Since this supplementary Paper discusses problems identified with revaluation, it seems unnecessary to discuss these problems in detail in this brief. The supplementary Paper included questions relating to:

(a) **liability:** Where will shareholders find cash to pay tax liabilities on deemed realization?

(b) **share control:** How will controlling shareholders retain control after a series of successive revaluations which require them to sell shares to meet the tax liability?

(c) **new public issues:** Will such a tax measure prevent private companies from going public and, if so, would it result in a greater number of foreign take-overs of private Canadian companies?

(d) **new public issues by foreign subsidiaries operating in Canada:** Will it discourage foreign companies operating in Canada from making shares in its Canadian operation available to Canadians? It certainly discriminates against such companies which have already taken this action.

Supplementary Paper 70-31 also identifies seven different modifications which have been suggested. In addition to these modifications, it has been suggested to the Federal Government that the 'deemed realization' proposal should be dropped entirely. The Government of Alberta agrees with this suggestion. The proposal should be dropped.

C. PROPOSED CAPITAL GAINS TAX ON SALE OF PRINCIPAL RESIDENCES

Under the White Paper proposals, a taxpayer who sells his principal residence would be subject to a capital gains tax on profits in excess of $1,000 per year of occupancy. Additional allowances would be given for home improvements and the proposal also includes certain 'rollover' provisions.

Supplementary Paper 70-33 released by the Department of Finance on March 16, 1970 dealt with this proposal in greater detail. The Government of Alberta feels compelled to express its opinion on this proposal, and the supplementary Paper, in the interests of many urban and rural homeowners, covering a range of income levels, who could be penalized by this proposal, depending on future inflationary trends and other factors.

1. The supplementary Paper states that the authors of the White Paper want to exclude most Canadian homes from any capital gains tax at all. In our opinion, Canadian citizens owning relatively low-cost homes, in addition to the 'well-to-do', would be subjected to some capital gains tax in the long run. The extent to which individual homeowners would be subjected to tax on the sale of their residences would depend on a number of factors including valuation of their houses on valuation day, the degree of future inflationary trends, and the degree of wear and tear and obsolescence of their houses.

2. Supplementary Paper 70-33 also states that some gains can result fortuitously—as a result of a re-zoning—and should be taxed. The statement is misleading. In our opinion, such situations are the exception rather than the rule and would make up a comparatively small share of total housing transactions.

3. Supplementary Paper 70-33 identifies certain deficiencies in the United States which the Government feels would be eliminated under the White Paper proposal for taxation of gains on sales of principal residences. According to this Paper, the United States system discourages older people from selling their homes. In our opinion, this same type of problem would develop in Canada under the White Paper proposal.

The supplementary Paper 70-33 also states that the U.S. system encourages people to buy more expensive housing each time they move. Although this may be true, other factors surely contribute to this situation, including: the need for a larger and therefore more expensive house; and, the long-term effects of inflation on selling prices of homes.

The final suggestion in the supplementary Paper that imputed rent should be taxed is unrealistic and another clear example of the obsession of the authors of the White Paper to penalize each and every attempt of Canadian citizens to save and invest.

The White Paper proposal to tax principal residences has a number of other weaknesses, including:

1. It discriminates between homeowners in the sense that, with increasing housing values, the respective owners would be subjected to increasing tax liabilities. The proposal ignores differing housing needs of our citizens. One taxpayer may require a much larger and therefore more expensive house than another taxpayer for one or more legitimate reasons, including size of family or economic conditions in the community where he is located.

2. It will force many taxpayers to change their intended way of life. For example, it could discourage them from selling their houses and moving into apartments, thereby interfering with their freedom of choice of residence.

3. It could cause unfair tax liabilities for Canadians who are subject to frequent transfer from one part of Canada to another. Losses in the sale of residences apparently will not be deductible, which could be unfair to taxpayers living in smaller communities which are gradually disappearing because of changes in economic conditions. For the same reason, it would be unfair to farmers who are forced to sell their operations at a loss.

Taxpayers owning houses currently valued above $14,000 to $18,000 could be affected by this proposal over the long term. If implemented, the proposal will be particularly onerous for middle-income Canadians who are homeowners. Home ownership is the principal asset of many Canadians. In addition, taxation of capital gains on the sale of principal residences likely will not produce a significant amount of tax revenues. For these reasons, this White Paper proposal should be dropped. Capital gains on the sale of principal residences should be tax exempt.

D. THE IMPACT OF COMBINED CAPITAL GAINS AND ESTATE TAXES

The White Paper proposes that capital gains should not be accrued at the time of death but that the person who inherits the assets should be treated as if he had purchased them at their cost to the deceased. There would not be a capital gains tax unless or until the executor or beneficiary disposes of the assets.

In many cases, assets will have to be sold by the beneficiaries or the executors within a short time after death in order to provide cash to pay estate taxes. At that point, gains on the sale of such assets would be subject to capital gains tax. This double payment would cause a very severe dilution of the capital base of otherwise healthy estates and, at the same time, would result in a shift of capital from the private to public sector. If the five-year revaluation proposal on widely-held company shares is eliminated, and the shares are subject to revaluation upon death, then the situation would be even more serious.

Because a great deal of commentary has been made about the combined effects that these two taxes would have on beneficiaries, it is not necessary to comment on them in more detail. However, the Government of Alberta cannot support the capital gains tax as proposed because of the adverse effect it would have in combination with the estate tax on the capital base of our citizens. The reason for our position is very simple. The requirements for private investment capital in Alberta, as in other parts of Canada, will be very great in future. Investment capital is, and will continue to be, in short supply.

E. EMIGRATION AND IMMIGRATION

Deemed realization would also occur under the White Paper tax reform measures when a taxpayer gives up Canadian residence. Also, when a person moves to Canada, he would generally be treated as though he had purchased his worldwide assets at fair market value on that day. As a result, Canada would tax only the increase in value that arises during the time that the owner of the assets is resident in Canada.

This proposal would have very serious consequences for the petroleum and related service industries operating in Alberta. It is common practice

to send employees on relatively short foreign assignments. Alternatively, there is frequently a need to bring specialists from other countries into Alberta on a short-term basis to participate in petroleum exploration and development and to train Canadian citizens. Implementation of these proposals would make it extremely difficult, if not impossible, to arrange such short-term transfers.

F. RELATIVE IMPORTANCE OF CAPITAL GAINS TAX AS A SOURCE OF REVENUES

Paragraph 3.55 of the White Paper points out that it is impossible to develop precise estimates of possible yields from a capital gains tax, although the Paper projects an annual figure of $390 million ultimately, or only about 5 per cent of total Canadian personal income tax. The revenue yields from taxation of capital gains in Canada will be relatively unimportant.

These estimates would appear to be based on rather cursory assessments of how the proposed system would work vis-a-vis actual experience in the United States. If this is correct, it is indeed unfortunate in view of the serious impact that imposition of such a tax would have on investment by Canadians. That progressive nature of the White Paper capital gains proposal, coupled with ultimate estate taxes, will be a very serious deterrent to investors, which could have very serious long-range implications in Canada in terms of employment and government revenues from personal and corporate taxes.

G. ALBERTA GOVERNMENT POSITION ON PROPOSED CAPITAL GAINS TAX

The Government of Alberta cannot accept the White Paper proposal for taxation of capital gains for the following reasons:

1. The taxable gain would be taxed at the marginal rate of the taxpayer, which will discourage taxpayers from making investments, particularly in resource industries. Petroleum and related service companies reinvest a comparatively large proportion of profits to finance expansion. Thus, shareholders in such companies look to capital gains, not dividends, as an investment incentive. New investment creates jobs and we have a sizable increase in our labour force appearing on the horizon.

2. The combined effect of the proposed capital gains tax and the estate and gift tax provisions would further decrease investor interest in Canadian investment opportunities.

3. The progressive nature of the proposed capital gains tax, estate taxes, and the formula for calculating taxable gain on residences, will result in a shift of capital or wealth from the private to the public sector, which we feel is unnecessary and undesirable.

4. The valuation day and five-year revaluation concepts are fraught with administrative and other problems which should have been evident to the authors of the White Paper. Total rejection of these concepts is necessary.

5. The anticipated revenues to the Government from the White Paper capital gains proposal, even in its present form, are small relative to other personal tax revenues. At the same time, the risk of adverse impacts on investor interest is very great and, unfortunately, cannot be determined with any degree of certainty. Therefore, in the interest of all Canadians, Canada

cannot run the risk that the economy would be adversely affected just to achieve the White Paper definition of equity, which in turn is questionable.

A number of guidelines have been suggested by others for establishing a reasonable capital gains tax in Canada. Such guidelines, including those listed below, would reduce the adverse effects of such a tax on the Canadian economy:

1. Capital gains should be taxed only when realized or upon death.

2. Capital gains on the sale of principal residences should be tax exempt.

3. A capital gains tax should have a much lower effective rate than that prevailing in the United States.

4. Effective capital gains rates should decrease as the length of asset ownership increases in order to recognize the long-range decline in purchasing power due to inflation.

5. The combined effect of capital gains tax and estate tax should not cause breakup of private pools of Canadian capital.

A capital gains tax designed around such guidelines would certainly be a vast improvement over the tax proposed in the White Paper. However, the Government of Alberta maintains the position which it expressed in response to the Carter Report, as indicated by the following excerpt from our 1967 brief:[3]

> "In view of the relative insignificance of capital gains tax as a revenue producer, it would seem imprudent to introduce a capital gains tax in Canada, a country which is chronically short of investment capital, particularly since governments are endeavouring to encourage Canadians to invest risk capital in the development of our natural resources. As pointed out in our White Paper on Human Resources Development, 'Canada is a relatively young nation; and Alberta is definitely a young Province. In many respects, Canada, and its Western provinces in particular, are still in a 'period of emergence'.' The proposed capital gains tax would work against our ultimate objective of 'Every Albertan A Shareholder'."

As further pointed out in the White Paper on Human Resources Development:

> "With the tendency of automation to give 'capital' an ever increasing role in the production of goods and services, it is desirable to do everything possible to increase the number of Albertans holding equity stock in local and national industry and receiving investment income to augment occupational income."

Our position is unchanged. We not only reject the proposed capital gains tax formula in the White Paper, we reject the concept of capital gains tax in Canada at this time.

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[3] Submission by the Government of the Province of Alberta Concerning the Report of the Royal Commission on Taxation, December 1967, page VII-9.

Chapter IV

CORPORATIONS AND THEIR SHAREHOLDERS

The purpose of this Chapter is to comment on those aspects of the White Paper proposals for taxation of corporations and their shareholders which are of particular concern to the Government of Alberta. In particular, we are concerned about the creditable tax system proposals, which if implemented could make it increasingly difficult for the petroleum industry to raise new capital, could encourage increased foreign ownership of resource industries, and would adversely affect the investment climate for fixed income securities.

In addition, we are concerned that the proposed system would create serious problems for small corporations. There are thousands of such corporations in Alberta.

Finally, we are concerned that the proposed system would create inequities for shareholders of investor-owned utilities and consequently would make it increasingly difficult for such companies to finance essential expansion of their operations, and might well tend to increase the degree of foreign ownership of such companies.

A. PROPOSED CREDITABLE TAX SYSTEM

The following discussion briefly outlines the White Paper proposals. This is followed by an expression of our concern that these proposals were based on an erroneous assumption by the White Paper authors concerning competition faced by closely-held and widely-held companies. The disadvantages of these White Paper proposals are then discussed in detail. This section of the Chapter concludes with our recommendation concerning these specific proposals.

1. The White Paper Proposals

The White Paper proposes to establish one set of rules for closely-held corporations and a different set for widely-held public corporations. The White Paper rationale for this distinction is:

(i) to reflect the purported difference between the two types of corporations and their respective shareholders. According to paragraph 1.40, closely-held companies are usually smaller businesses managed by the shareholders and, therefore, the tax should be related as closely as possible to rates paid by individual shareholders. Paragraph 1.42 takes the position that the link between shareholders and management of widely-held corporations is tenuous.

(ii) to reflect the fact that, by and large, the closely-held corporation competes with proprietorships, partnerships and other closely-held corporations while the widely-held public corporations compete with other widely-held public corporations.

(a) Closely-Held Corporations

In the case of closely-held corporations, the White Paper proposes that there would be a tax of 50 per cent on the taxable income of the corporation. However, upon distribution of net profits to the shareholders,

credit would be given for the full amount of the tax paid by the corporation on those profits.

Gains on the sale of shares of closely-held Canadian corporations would be fully taxed, and losses on the sale of such shares would be fully deductible. The rationale for this proposed treatment is that, when coupled with the credit given to Canadian shareholders for the Canadian corporate tax paid by these companies, there would be little, if any, tax advantage to be secured by a taxpayer through receiving his share of the income of the corporation in the form of gains on the sale of shares rather than dividends, or vice versa.

(b) **Widely-Held Corporations**

The White Paper proposal would not give Canadian shareholders of widely-held corporations full credit for the corporation taxes paid by those corporations. The White Paper would replace the existing dividend tax credit with a system giving Canadian shareholders credit for one-half the Canadian corporation tax paid by the corporation on the profits from which the dividend is paid.

Only one-half of the gains on the sale of shares in widely-held Canadian companies (for taxpayers other than widely-held companies) would be included in taxable income and taxpayers would deduct only one-half of their losses.[1] The rationale for this proposal is that it would put Canadians in approximately the same position as most of the non-residents who invest in Canada. Also, the 50 per cent taxability of such gains, coupled with the 50 per cent credit for corporate tax paid by such corporations, should also result in little incentive for Canadians to receive their income in the form of gains rather than dividends, and vice versa.

The White Paper holds that this system would increase equity between shareholders with different marginal tax rates. In addition, it would eliminate situations under the present dividend tax credit system whereby, in certain companies, shareholders receive dividends and a dividend tax credit when, in fact, no corporation tax has been paid.

2. **Erroneous Assumption Regarding Competition for Closely-Held and Widely-Held Companies**

The Government of Alberta cannot accept the following statement from paragraph 4.19 of the White Paper in support of its proposal to create one set of rules for the closely-held and another set of rules for the widely-held corporations:

> ". . . It also reflects the fact that, by and large, the closely-held corporation competes with proprietorships, partnerships, and of course with other closely-held corporations, while the public corporation competes with other public corporations, both Canadian and foreign."

We do not believe this is a fact, nor do we think it is a valid generalization. In Alberta, for example, major international petroleum companies actively compete with relatively small independent Canadian companies in the search for hydrocarbons. Relatively small trucking companies compete against the Canadian Pacific and Canadian National in meeting certain transportation demands. The small computer service centre competes against I.B.M. Because this basic White Paper premise is wrong, we do not believe

[1] However, as discussed in Chapter III taxpayers would be required to revalue these shares to market every five years and take one-half of the resulting gain or loss into account for tax purposes in that year.

that the White Paper objective to put closely-held corporations as nearly as possible in the same tax position as their competitors can be achieved.

The Minister of Finance discussed the purported distinction between closely-held and widely-held companies in a recent speech to the Tax Executives Institute.[2] He pointed out the above excerpt from paragraph 4.19 has been quoted and criticized repeatedly, but without using the opening words "by and large". It seems to be his view that the omission of these words changed the intended meaning in the White Paper. However, the White Paper makes other references to the purported competitive differences between closely-held and widely-held corporations including:

> ". . . These (closely-held) corporations usually compete in markets with unincorporated businesses subject only to personal income tax." (paragraph 1.40)

> ". . . (Widely-held) corporations are themselves important economic entities. Their products or services are usually sold in competition with other large corporations, where prices yield an adequate return after paying corporate tax." (paragraph 1.42).

It seems clear from these quotes that the White Paper authors believe that closely-held companies generally compete with other closely-held companies and that widely-held companies generally compete with other widely-held companies. In his May 21st speech, the Minister of Finance stated that: "Of course there is some direct competition between closely-held and widely-held corporations."

We believe that there is a great deal more competition between these two classifications of corporations than is implied by this statement. In our opinion, closely-held companies compete with widely-held companies in almost every line of endeavour. We believe this is the rule rather than the exception. If the basic premise is wrong, then surely the proposals arising therefrom must be discounted. The May 21st speech by the Minister of Finance attempts to prove that the closely-held corporation and its shareholders "get the better things." We frankly admit, however, that we found this lengthy discussion quite ambiguous. For these reasons, the major tax reform proposal based on this highly questionable assumption by the authors of the White Paper must be seriously re-examined.

3. Disadvantages of the White Paper Proposals

The White Paper proposals for treatment of corporations and their shareholders would have a number of undesirable features which directly or indirectly would not be in the best interests of Alberta.

The White Paper proposes to give certain depletion allowances to mineral industries which would have the effect of reducing the corporate tax which they pay. At the same time, however, implementation of the new proposals would effectively take away the benefits of that depletion allowance from shareholders of such corporations. Since the tax paid by the corporation would be reduced by the depletion allowances, the shareholder would have reduced or no creditable tax to apply against the dividends he receives from these corporations. This obviously makes an investment by Canadians in these corporations considerably less attractive than an investment in manufacturing, industrial or commercial enterprises.

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[2] Taxation of Corporations and Their Shareholders, an address by Finance Minister E. J. Benson to the Biennial Conference of the Tax Executive Institute, Ottawa, May 21, 1970.

Many companies in the petroleum industry, including pipelines, are low tax-paying, low-dividend-paying corporations. New investment capital is attracted by the prospect of capital appreciation created by the dynamic growth potential of the petroleum industry, not because it offers an assured source of stable income. The low creditable tax position of many petroleum companies under the White Paper system would cause Canadian investors to seek high tax-paying, high-dividend-paying companies in more mature industries. This feature, combined with other proposals such as the (i) elimination of depletion allowance on dividends; (ii) implementation of a severe capital gains tax; and, (iii) higher personal tax rates for middle income earners, would discourage Canadian investment in the petroleum industry if implemented. Even with present incentives, the petroleum industry experiences difficulty in attracting Canadian equity and debt capital. The proposed system would further aggravate this problem.

The reduced incentive for Canadian investment in the industry under the proposed system would depress stock prices, thus creating an attractive situation for foreign investment, as would the further downward pressure on stock prices which would be exerted by the 2½ year limit on the payment of cash or stock dividends against which creditable tax would be claimed. Petroleum companies rely heavily on internally-generated funds for exploration and development. Their needs for this activity are expected to accelerate substantially over the next few years. Therefore, cash for dividends will not be available and the alternative of stock dividends is unattractive because it normally precipitates additional selling and lower market values, and can inhibit equity financing due to over capitalization.

As far as the petroleum industry is concerned, therefore, these integration proposals, if implemented, would produce the following undesirable results:

(i) Canadian investment capital would be diverted to mature industries;

(ii) the ability to raise new capital would be impaired; and,

(iii) increased foreign ownership would be encouraged because disincentives to Canadian investor interest would cause stock market values of these companies to decline. The White Paper states in paragraph 1.5 that the proposed system for taxation of corporations would stimulate Canadian ownership of Canadian business. In the case of petroleum an opposite effect will result.

The Canadian petroleum industry has long-term dynamic growth potential which, if realized, will stimulate regional and overall national economic growth. For example, there is no other industry which can stimulate or accelerate the opening up of the Canadian North. However, as discussed in Chapter VIII, it will be necessary for the industry to attract huge sums of capital to finance this growth. A favourable investment climate and adequate rate of return commensurate with risk will be imperative if such potential is to be realized.

As far as Canadians are concerned, the shift in the pattern of investing caused by implementation of these White Paper proposals would have severe detrimental results to provinces like Alberta which have large natural resources reserves for development. The economic development of the Province of Alberta is paramount to this government and, therefore, we cannot concur in so-called tax reforms which could have the opposite effect. To the extent that there is a reduction in the economic activity in the Province of Alberta, the demand for all types of manufactured goods and services

required by the petroleum industry, most of which come from other parts of Canada, will be reduced. The tremendous need in Alberta for such goods and services has been ably documented in many other briefs.

The new integration proposals are based on the assumption that corporations would pay their taxes on essentially the same basis as at present. This means that the corporation tax would be distributed between the Federal Government and the provincial governments, with each provincial government being entitled to a share of tax based on the business carried on by the corporation in each province. The new integration proposals provide that a shareholder would claim certain credits based on the dividends which he receives from the corporation and on the rate of tax paid by the corporation. No information is contained in the White Paper to indicate whether the shareholder claimants of this credit would be distributed throughout the provinces on the same basis as that on which the share of the tax paid by the corporation is distributed to the provinces. This appears to be a serious omission in the information in the White Paper and we feel that the Government of Canada must provide some adequate and comprehensive studies in this regard. It also seems that the end result would be increased complexity of our system.

The dividend tax credit system has provided a benefit to Canadians only, since non-residents of Canada do not report dividend incomes in a Canadian tax return other than the fact that they have the usual 15 per cent or 10 per cent tax withheld at source. The United States has a somewhat similar system which is restricted to residents of the United States, although their dividend tax credit has not been as generous as that in Canada. A change over to the creditable tax system could result in non-residents receiving some benefit from the creditable tax, depending on the treaties that are negotiated with other countries. Since United States entities already have fairly large holdings in shares in Canadian corporations, a revised treaty between Canada and the United States could have a definite impact on the net revenues in Canada. No such figures are set forth in the White Paper.

The White Paper proposals will also adversely affect the investment climate for fixed-income securities, which is so important to the Federal and provincial governments.

The White Paper proposals to 'gross up and credit' with respect to shareholders of corporations will make such equity investment more attractive compared to fixed-income securities. Furthermore, the proposal to fully tax capital gains and losses on bonds and mortgages will further reduce incentive to invest in these securities.

The bond market is an absolute necessity to all governments and agencies in financing capital projects. Present unfavourable money markets make borrowing difficult and expensive. It is unfortunate that the White Paper authors should suggest tax proposals that would aggravate these difficulties, particularly when the Federal Government itself will likely be a large borrower.

If 'gross up and credit' with respect to most equities is to become law, then there should be some compensating incentive for investors in income securities. Perhaps there could be a modest interest tax credit available to bond and mortgage holders, or, at the very least, the proposal to tax gains and losses should be removed.

It is surely obvious that a considerable portion of our economy will remain strong only so long as adequate public expenditures are made. If

the availability of such funds for these expenditures is reduced by government action, then the whole exercise might adversely affect many aspects of the economy and reduce the value of equity investment accordingly.

Alberta does not suggest that bond financing should be unduly inexpensive or available. This would tend to encourage introduction of unessential programs. Rather we contend that bond financing is important and that there should be a relative attractiveness to the investors in bonds versus stocks.

The mechanisms proposed in the White Paper for giving shareholders credit for corporation taxes paid could also place corporate directors in an onerous position at the commencement of the program. This is evident when one studies the following excerpt from Supplementary Paper 70-34 released by the Department of Finance on March 19, 1970, page 18:

> "The opening share value for purposes of the computation of the difference would be declared by the board of directors of the corporation at the time of filing the corporation's first tax return under the new system. This declaration would set out the board's opinion of the fair market value of all of the shares of the corporation if they were sold in a block to one buyer. Even though this valuation were agreed with the Department of National Revenue, it would not be binding on individual shareholders in their determination of the Valuation Day value of their holdings. It would be open to them to argue that their particular holding was worth more than average (e.g. since it carried with it control of the corporation) or less than average (e.g. since it did not have voting rights) or indeed that the 'average' was itself incorrect. In this latter connection, the 'average' value as agreed with the board of directors would be the beginning point for the Department's valuations or individual holdings, and might be expected to have some influence on the courts as evidence of the value of the corporation."

It is interesting to note that the integration system used in the United Kingdom was essentially abandoned in 1965. In our opinion, the White Paper should have reported on the basis for this development. We fail to understand how the people of Canada, very few of whom can be expected to have detailed tax knowledge, particularly in regard to other countries, would comprehend the significance of this move to full integration unless the Government of Canada lays all the facts before them, both pro and con.

Because of the damaging effect the proposed new system would have on Canada's investment climate and economic development, **we recommend:**

(i) **rejection** of the **proposed** creditable tax system; and,

(ii) **retention** and possibly liberalization of the dividend tax credit. The existing system at least reduces to a reasonable extent double taxation of corporate income and it is far less complex to administer.

B. IMPACT ON SMALL BUSINESS

This section begins with a brief description of small business and the importance of small corporations in Alberta. This is followed by a discussion of the present tax position of small corporations and under the proposed White Paper system. This section of Chapter IV concludes with our recommendations concerning these proposals.

1. Definition of Small Business

The term small business, in itself, is difficult to define. The Canadian Small Business Loan Act apparently defines a small business enterprise as one which has gross revenue not in excess of $500,000 per year. The Carter Report defined small businesses as those having assets of less than $1 million and gross revenues less than $10 million.

A letter dated February 11, 1970 by the Minister of Finance contained the following information about Alberta corporations in 1967:

Corporations with Taxable Income Less Than $35,000
Allocation of Taxable Income by Range of Taxable Income

Range of Taxable Income	Taxable Income 000's of $	%	Number of Taxable Corporations*
$ 1 - $ 1,999	$ 1,612	1.9	1,929
2,000 - 4,999	5,534	6.7	1,669
5,000 - 9,999	11,994	14.6	1,646
10,000 - 19,999	23,678	28.8	1,621
20,000 - 34,999	39,511	48.0	1,343
	$82,329	100.0	8,208*

* operating exclusively in Alberta.

This same letter indicated that approximately 79 per cent of the total taxable income of $382,498,000 of corporations in Alberta, or about $300 million, was earned by corporations that had a profit of $35,000 or more. There were 614 taxable companies operating exclusively in Alberta in 1967 with taxable income in excess of $35,000.

Alberta Bureau of Statistics provided the following data concerning business establishments operating in Alberta in 1968:

Total number of business establishments	17,248
Gross revenue (millions of $)	2,918
Numbers of employees	93,191

It is evident therefore, that the operations of a significant number of companies in Alberta would be influenced by implementation of these White Paper proposals.

2. The Tax Position of Small Corporations Under the Present Act

Paragraphs 4.9 and 4.10 of the White Paper describe two important changes which were made in the tax system in 1949 to eliminate disadvantages which faced small corporations relative to the unincorporated businesses. These changes were introduction of (1) a two-rate system, and (2) a dividend tax credit. Both of these features would be eliminated under the White Paper system.

The two-rate system has helped small corporations to finance their growth since generally they find it difficult to secure relatively low-cost long-term debt or equity financing. Fixed costs of servicing loans or financing equities are relatively higher than for bigger corporations. The lower rate of corporate tax on the first $35,000 taxable income encourages entrepreneurs to enter into business.

It is true of course that the present system has some weaknesses. For many years, tax avoidance was achieved by some corporate taxpayers

through the vehicle of 'associated' companies. This loophole has been largely eliminated as a result of changes in the Income Tax Act and more effective administration of the Act.

It is true that the dual-rate corporate tax structure aids large as well as small businesses. It probably does not represent a serious revenue loss to the government. In our opinion, it would be imprudent to drop the low corporate rate in order to remove an insignificant benefit from large companies if such a step would cause a very serious financial problem for small companies. Here again, the White Paper revenue estimates appear faulty. They apparently assume that if the low rate is removed, the total taxable income position of all small companies will remain the same. This is unlikely to be the situation. Total taxable income would be reduced by the extent to which small businesses are forced out of business. In other words, it is not just the taxable income of a business which governs the viability of a business. It is governed by its ability to generate sufficient net cash inflows to meet financial commitments. The net cash position of the small corporation under a White Paper system would be reduced by at least the amount of the increased tax liability.

The White Paper acknowledged that its proposed system:

> "Would substantially increase the taxes to be borne by existing small corporations, and many of these corporations may have made financial commitments based upon the present tax system and the after-tax income they can expect under the system."

Unfortunately, the authors of the White Paper apparently made no attempt to determine the seriousness of this problem. Removal of the lower corporate rate would increase the tax liability and therefore reduce the net cash inflow of a company at the $35,000 taxable income level by about $10,000 per year, equivalent to a 140 per cent increase in corporate taxes.

It is also true that a number of businesses cannot incorporate and therefore receive no benefit from the low corporate rate. In his May 21st speech the Minister of Finance referred to the case of insurance agencies:

> "Some life insurance companies permit their salesmen to incorporate, others do not. The result is a difference in tax burdens between persons providing the same services and having the same before tax incomes."

This inequity could also be removed if all the insurance companies had a uniform policy regarding incorporation. In other words, tax reform is not the only way of removing this inequity.

Before eliminating the low corporate rate the Federal Government should undertake a comprehensive analysis showing the taxes paid by small unincorporated companies versus small incorporated companies. Many of the unincorporated businesses probably have very low effective tax rates. If this is true, the existing low corporate rate does not really provide the small incorporated company with a significant tax advantage.

3. The Tax Position of Small Companies Under the White Paper System

Paragraph 4.28 of the White Paper states that:

> "In effect, the present system gives an arbitrary concession to small corporations. The proposed system would graduate the tax according to the circumstances of the shareholders. Therefore the benefit would go to shareholders with small incomes rather than to corporations with small incomes."

Briefly, the White Paper proposals which would affect small corporations include (1) the removal of the lower corporate tax rate on the first $35,000 taxable income, (2) total integration of corporate and shareholder income, (3) capital gains on the shares of such companies would be taxable at full marginal rates, (4) there would be no deemed realization of capital gains on death and a beneficiary would have a cost base equal to the cost to the deceased plus that part of any death duties attributable to the increased value of the shares, and, (5) under certain conditions, companies would have a partnership option.

The hardships of the White Paper system on small corporations may be summarized as follows:

(a) The small corporations which would be hardest hit would be those with growth potential that can be achieved partly or wholly from expansion generated from retained earnings. As indicated earlier, these corporations normally have difficulty expanding to any extent from outside sources.

(b) The 5-year transitional period for removal of the lower rate is far too short and would be particularly onerous for those companies with long-term financial commitments.

4. **Alternative Incentives For Small Corporations**

A number of alternative incentives for small corporations have been suggested including the Carter recommendation for accelerated or additional capital cost allowances, which of course, would not assist service industry or similar corporations with relatively small investments in fixed assets. Other suggestions include: government loans; deferment of taxes until owners have recovered their investment; and, a sliding scale of tax rates tied to changes in taxable income.

The Federal Government has established a team of Federal civil servants to study this whole question of tax relief for small business. The Minister of Finance referred to this matter in his May 21st speech when he stated:

> "the government has asked a group of officials from various departments to examine the problem and to recommend a better solution or solutions."

As part of its assignment the team apparently has been asked to study whether or not small business really needs assistance, and if so why. The Government of Alberta believes very strongly that such incentives are needed to assist small corporations to finance their operations and because "mighty oaks from little acorns grow."

We feel obligated to state that, in our opinion, the authors of the White Paper were remiss in not anticipating the magnitude of hardships which its system could create for small corporations, and in not devising alternatives to offset the impact which removal of the lower tax rate would have on them. In other words, the assignment presently being undertaken by the Federal Government team should have been undertaken in depth before, not after, preparation of the White Paper.

5. **Recommendation of the Government of Alberta**

The present system of low corporate rate must be retained until an equally or more effective incentive system can be developed. The proposed White Paper approach is completely opposite and much more uncertain;

that is, eliminate the lower corporate rate and if the result is detrimental develop other incentives or presumably re-introduce the lower corporate rate. We do not feel that Canada should incur this risk since if the effect is detrimental, small corporations may be beyond recovery.

C. PROPOSED TAXATION OF INVESTOR-OWNED PUBLIC UTILITIES

Paragraphs 4.63 to 4.65 inclusive of the White Paper deal with the proposed treatment of shareholders of electric, gas or steam utilities. Under the Public Utilities Income Tax Transfer Act of 1966, the Federal Government turned over 95 per cent of the corporation tax collected from certain electric, steam and gas utility corporations to the provincial governments.

In 1966, the Utility Companies Income Tax Rebates Act was passed in Alberta. This Act provided the mechanism for rebating the proceeds from the Federal Government tax transfer, plus 100 per cent of the Alberta corporate income tax from these companies to utility consumers in Alberta using the Alberta utility companies as the disbursing agents.

Paragraph 4.64 of the White Paper points out that:

> "The whole scheme of the proposals contemplates that shareholders of Canadian corporations receive a credit from the federal government for part or all of the federal corporation tax paid by their corporations."

The White Paper system would **not** give:

> "shareholders of these utility corporations credit for taxes which the federal government has turned over to the provincial governments . . ."

Paragraph 4.65 points out that it would be possible to give the shareholders credit for the taxes which the federal government retains, but suggests that it would be more efficient to turn over all of these taxes to the provinces who could then decide to what extent they should be turned over to the respective corporations or their shareholders.

If the White Paper proposal to switch from the existing dividend tax credit system to a creditable tax system is implemented, shareholders of investor-owned utilities will not be eligible for any creditable tax.

Therefore, the proposal places any tax benefit to these shareholders in jeopardy with the obvious result of making an investment in such shares much less desirable. Implementation of the proposal would increase the cost of raising new equity capital and borrowed funds, and undoubtedly would result in higher consumer costs and/or insufficient expansion of facilities to meet anticipated demand. Neither of these possibilities can be tolerated.

Foreign investors, unaffected by the tax reform proposals, would find Canadian utility shares increasingly attractive, thus imposing a definite and serious threat to Canadian control of a vital industry at the expense of existing Canadian investors who, through no fault of their own, would suffer severe capital losses with no tax relief. This situation would develop because, as the dividend rate increased to compensate for the lack of the creditable tax benefit, these higher rates would become attractive to non-residents of Canada. Canada would withhold only the flat 15 per cent on these dividends going to non-residents and, of course, the non-resident would still pay his usual tax in his own country. However, the rate of return from these public utility companies would be higher than in similar companies elsewhere.

Therefore, non-residents would be bound to be attracted. It is not in the best interests of Canada or Alberta to promote a situation whereby non-residents are actively enticed into taking control of our public utilities.

The Government of Alberta takes the following position on the specific White Paper proposals for taxation of investor-owned utilities:

1. Since investor-owned utility companies will continue to pay corporation income tax just as other widely-held corporations, their shareholders should be eligible for similar tax treatment on dividends.

2. If there are additional costs due to any change in the tax treatment on dividends, then the Federal Government, in consultation with the Provinces, should review its Public Utilities Income Tax Transfer Act, and if necessary make appropriate amendments so that it does not assume any additional cost.

3. Since the present arrangements were made by the Federal Government in 1966 for the purpose of removing the tax differential between investor-owned and government-owned utility companies in expectation that consumers would benefit, this beneficial action should not now be jeopardized, and any action that may become desirable as a result of any other tax reform should be resolved between the Federal Government and the Provinces at the earliest possible opportunity without any need for inclusion in a Tax Reform Bill.

4. The proposals in paragraphs 4.63, 4.64 and 4.65 of the White Paper deal with the disposal of corporation income tax paid by certain public utility companies and do not contribute to tax reform. Therefore, these proposals should be withdrawn.

Chapter V

BUSINESS AND PROPERTY INCOME AND TAXING INTERNATIONAL INCOME

Chapter 5 of the White Paper deals with "Business and Property Income" under a number of major headings including farmers and fishermen and mining and petroleum. The position of the Government of Alberta regarding taxation of farmers and the petroleum industry is discussed in detail in Chapters VII and VIII, respectively, of this brief. Our comments on Chapter 5 of the White Paper will be restricted to its proposals concerning entertainment and related expenses, and trusts.

Chapter 6 of the White Paper deals with "Taxing International Income" under two broad headings: (1) Foreign-Source Income of Canadians; and, (2) The Canadian Treatment of Non-Residents. Our comments will be restricted to impact of the White Paper proposals, if implemented, on taxation of non-residents.

A. ENTERTAINMENT AND RELATED EXPENSES

We strongly support the White Paper proposal to eliminate indiscriminate use of 'expense account' living. However, we believe the proposal is too inflexible and impractical. For example, the proposal that costs of attending conventions would not be allowed as a charge in determining business income is too inflexible. Many conventions revolve around formal programs specifically designed to develop the professional or vocational capabilities of those in attendance. Admittedly, others are designed primarily as social events. The White Paper proposal would be unfair to companies or organizations sending delegates to the former type of convention. As a result of such a tax measure, staff development would likely decrease.

Also, a reasonable tax proposal dealing with allowable entertainment and related expenses must recognize the legitimate differences in sales promotion and development programs between industries. For example, in many industries sales promotion is highly personalized. In fact, certain professional organizations are not allowed to advertise their services except in a very restricted manner. In these highly personalized businesses, luncheon engagements with customers or prospective customers, whether at a private club or elsewhere, are an accepted method of developing business. In fact, the promotional and entertainment expenses expressed as a per cent of revenue may well be much lower than the same ratio in other industries which depend to a large extent on newspaper, radio, and television advertising. Heavy reliance on advertising could be very wasteful for those industries or services which must be conducted in a highly personalized way.

Identifying specific expense items which would not be deductible for tax purposes, as is implied in the White Paper proposal relating to 'expense account living', would be discriminatory. In our opinion, indiscriminate 'expense account living' can be effectively stopped through administration of the law.

B. TRUSTS

The White Paper outlined aspects of taxation of trusts under the present tax system which it feels are unfair. The White Paper proposes to close these 'loopholes' by treating certain types of trusts as corporations or as mutual funds. For other trusts, income accumulated in such trusts would be subject to a flat rate federal tax of 40 per cent.

In the interest of preventing tax avoidance, the White Paper proposal could create serious hardships for many legitimate trusts. Therefore, we strongly recommend that this proposal should be amended so as to prevent such situations from developing. Once again, proper administration of the tax act is the appropriate way to minimize tax abuses without creating hardships for taxpayers.

C. THE CANADIAN TAX TREATMENT OF NON-RESIDENTS

The proposed tax treatment of non-residents is of particular interest to the Government of Alberta in view of the very great importance which foreign capital has played in the development of our petroleum industry. As indicated in Chapters VI and VIII of this brief, the petroleum industry will continue to need substantial amounts of new domestic and foreign capital in the years ahead. Therefore, the basis for taxing non-residents must be fair and in line with tax treatment of non-residents by other countries.

At the time of the Leduc discovery in 1947, very few Canadians had the technical knowledge required to find and produce oil and natural gas. Fortunately, many highly educated and well trained people came to Canada and assisted in what turned out to be a tremendous economic development. We now have many trained Canadians but we continue to benefit from specialized knowledge and research facilities available from other countries. A sizable number of petroleum industry personnel have taken out Canadian citizenship after following the oil industry into Canada. We do not wish to see additional hardships imposed on foreign technical personnel that will continue to be required in Canada.

The substantial sums of capital required in this industry are also very important. Canada could never have provided the capital requirements of the Canadian petroleum industry during the last twenty years. It is unlikely that Canada will be able to provide the total additional capital required by this industry in the next decade. Any changes in the method of taxation in Canada that will reduce these expenditures to any appreciable degree will be detrimental to our economy. As pointed out in Chapter VIII, this industry has provided a substantial source of income to the Government of Alberta. It has built new towns, opened up the country by building roads in previously inaccessible areas, provided off-season employment to many of our rural people, and, provided trade and commerce in many of the small towns and villages.

Canadians by and large have not been heavy direct investors in the petroleum industry. They have performed quite well in drilling companies, supply houses, pipe manufacturing companies, and many other businesses serving the industry, but have supplied a comparatively small amount of the risk capital for finding and developing oil reserves. It is only when these risk funds have been made available for development that the service and other related businesses obtain customers for their products and services.

Canadians have preferred to buy stable securities such as bonds, except they have made substantial investments of risk capital in the mining industry. This industry, headquartered primarily in the Toronto area, was commenced a great many years ago. People who provided risk capital to mining understood the industry. However, when petroleum was discovered in Western Canada, they did not understand that industry. Also, Eastern Canadian capital did not appear too interested in investing in the West.

What is possibly more important is that Canadian tax laws deterred Canadians, as individuals, from investing in this industry. If they drilled a dry hole, Canadian tax laws specified that cost to be a capital loss, and consequently it was non-deductible for tax purposes. If they drilled a producing well, they were then permitted to deduct their drilling costs from their income from production. The same situation applied to all corporations unless they fell within a restricted 'principal business' concept. American entities had no such restrictions and they could charge their costs against any other income they had. They could better afford to take the risk and, as a result, their capital flowed into Alberta through corporations, partnerships and individuals.

The White Paper now suggests that Canadian entities can put their expenditures into a special class and take 20 per cent capital cost allowance per annum thereon. We see no reason to limit the amount to 20 per cent, and suggest it should be 100 per cent.

We are advised that when an oil company brings highly-skilled personnel to Canada they must increase their salaries by 10 to 20 per cent so that they have the same net pay or net salary after tax as they would in the United States. The increase in tax rates proposed by the White Paper for the middle income group will aggravate the situation even further and, as a result, it may be nearly impossible to afford to bring these highly-skilled personnel to Canada. Of greater significance, this disparity will also cause us to lose more and more of our highly-trained Canadians. Petroleum is a world-wide business and there is a relatively free flow of personnel between different oil-producing countries. We are concerned that the 'brain drain', as far as Alberta is concerned, will once again switch around to be an out-flow from Canada instead of an in-flow. This subject is also discussed in Chapter III.

The addition of a capital gains tax in Canada would affect the net return. Those foreign companies who own shares in Canada can be seriously affected in some instances. If those companies have heeded the request of the Canadian Government to let Canadians participate in their operations through issue of Canadian shares, they will be subject to the five-year revaluation suggestions under the White Paper system. This will effectively prevent other foreign companies from issuing shares in Canada.

Also, the proposed changes to reduce depletion on working interests and eliminate depletion on royalty interests will reduce the net return in Canada. Since corporate tax rates are already higher in Canada than the United States, the United States company cannot recover all the Canadian tax because its United States tax credit is limited to the rate of tax payable in the United States. To the extent that Canadian taxes go up, regardless of whether by increase in rate or by a change in the computation of taxable income, such increased cost will reduce the net return and therefore make investment in Canada less favourable. This could very easily divert new foreign capital presently destined for Canada to Alaska, Australia, Indonesia, or other countries where mineral exploration is attractive.

The Canadian Government has quite rightly felt that it would prefer to have its resources developed by Canadian companies. As a result, many foreign corporations have set up Canadian companies rather than operating as a Canadian branch office.

Implementation of the White Paper proposal in regard to 'thin' capitalization will have the opposite effect. Most foreign corporations would prefer to operate on the branch basis rather than on a Canadian subsidiary basis under such a system.

Chapter VI

IMPACT ON REVENUES AND THE ECONOMY

Chapter 8 of the White Paper deals with the impact of its proposed taxation system on federal and provincial government revenues and, in a somewhat superficial manner, on the economy. The primary purpose of Chapter VI of this Alberta submission is to comment briefly on these same subjects. Reference is made to impacts in terms of revenue, investment, balance of payments, and employment. Chapters VII and VIII, respectively, comment in some detail on the impact of the proposed White Paper system on agriculture and the petroleum industry.

A. IMPACT ON PROVINCIAL GOVERNMENT REVENUES

Paragraph 8.2 of the White Paper states that:

> "The revenues of the provinces should also be approximately the same under the proposed system as under the present system."

Revenue estimates included in the White Paper were prepared on the basis that the provinces will not change the relative proportion of their personal income taxes to federal income taxes, or their respective rates of corporate tax.

Paragraph 8.34, dealing with the same subject, states:

> ". . . The total provincial revenues from personal income tax would be down less than 1 per cent but this decrease would be more than offset by the increase in corporation taxes. At the same time, the three provinces that are not protected against individual reductions in tax yields all would have increases."

These statements only deal with part of the provincial revenue picture that is, personal and corporate income taxes. In Chapter VIII, we refer to the strong relationship between annual investment in the petroleum industry and revenues accruing to the Alberta Government. In recent years, Alberta Government revenues coming from the sale of crown-owned mineral rights have ranged from 15 per cent to 20 per cent of total annual capital investment by the industry.

Chapter VIII also indicates that Alberta Government revenues from the petroleum industry could be reduced by $60 to $100 million per year as a result of implementation of the White Paper proposals without allowing for indirect effects such as reduced taxes paid by industries servicing the petroleum industry and by their employees. This Chapter VIII analysis points out one of the basic flaws in the White Paper revenue estimates. They are based on the assumption that economic activity will not change significantly if its taxation system is adopted.

B. IMPACT ON THE ECONOMY

1. Investment

The White Paper admits that under its proposed system new investment in the petroleum industry would be reduced. This observation has been

supported in published statements by banking and investment experts and in specific submissions in response to the White Paper.

The uncertainty relating to the White Paper, coupled with more recent developments in the Canadian economy, will make it increasingly difficult for the petroleum industry to find the total investment capital it will require in the 1970's. This type of development would affect Canadian balance of payments, employment, emigration and standard of living of Albertans.

The Canadian petroleum industry will require over $20 billion in the next decade for investment in exploration and development and related activities. These estimates reflect the increasing importance of exploration activities in the higher cost northerly areas of Canada and expected continuation of inflationary trends.

The uncertainty related to the White Paper purportedly has already reduced availability of new foreign capital to some extent. In addition, other recent developments are having an adverse impact on investor confidence, including:

1. the revocation by the Federal Government of oil and gas land Order No. 1-1961 which is considered by many to be retroactive and confiscatory;

2. the inference in a recent speech by the Hon. J. J. Greene, Minister of Energy, Mines & Resources[1] regarding foreign investment in Canadian industry; and,

3. prevention, with little advance warning, of the sale of controlling interest of Dennison Mines to United States interests.

The Government of Alberta supports the aim to increase Canadian ownership of our industry and commerce. In fact, in Chapter IX of this brief we express concern that certain White Paper proposals, if implemented, would work against this laudable objective. However, we are concerned that these Federal Government actions — which occurred in a relatively short period of time and do not provide for a reasonable period of transition for investors to adjust to new policies — were taken with little if any forewarning to those directly affected. The nature of these actions, on top of the White Paper proposals, raises a valid question as to whether or not the Federal Government has established a new and less favourable attitude towards foreign investment.

2. Balance of Payments

Any reduction of foreign investment in the petroleum industry because of these uncertainties would adversely influence the Canadian balance of international payments in the following ways:

(a) reduction in net capital inflows from direct foreign investment in Canada or sale of Canadian securities outside the country;

(b) reduction in net exports of oil, natural gas, and by-products because of reduced investment and therefore, proportionately lower reserve additions; and,

(c) repatriation of foreign capital and retained earnings.

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[1] In an address to the Independent Petroleum Association of America, at Denver, Colorado, on May 12, 1970 entitled 'In Lieu of "Old No. 23."'

For these reasons, and because of the importance of the petroleum industry to merchandise trade and capital account balances, we disagree with the statement in paragraph 8.50 of the White Paper to the effect that on the whole the balance of payments:

> ". . . should be modestly improved. . . The net effect should be well within the range with which the normal off-setting and adjusting mechanisms can deal."

3. Employment

A reduction of foreign investment in the Canadian petroleum industry due to implementation of the White Paper taxation system would certainly contribute to increasing unemployment in Alberta, particularly for unskilled and semi-skilled segments of the labour force. Increased unemployment would cut across a large portion of the Alberta labour force, from professionally trained specialists such as geologists and petroleum engineers to unskilled labourers. For example, capital investment in the petroleum industry directly or indirectly has generated a large, viable, and diversified construction industry supplying the need for high-rise apartments, office buildings, gas plants, pipelines, and highways. As pointed out in our 1967 reply to the Carter Commission:

> "The total gross value of construction in Alberta (including new construction and repairs) rose from $556 million in 1953 to $1.21 billion by 1966. The petroleum industry makes a very significant direct contribution to construction activity in Alberta. In 1966, it accounted for $347 million or 28 per cent of total gross value of construction activity, which compares with only 3 per cent in the remainder of Canada. This does not include the amount contributed to residential, industrial, commercial, road or electric power construction."

Much has been written about the multiplier effect resulting from investment in primary resource industries such as petroleum exploration and development. The total labour force in Alberta increased from 302,000 in 1946, just before the Leduc discovery, to 560,000 in 1966. Increased employment in services, wholesale and retail trade and construction accounted for about 75 per cent of this total increase.

The need to maintain a high level of economic activity is apparent from the expected growth in the Canadian and Alberta labour force. According to the Economic Council of Canada,[2] in the 1965 to 1975 period, Canada will be faced with the most rapidly growing labour force of any industrial nation. According to the Council, the Canadian economy will have to provide 240,000 new jobs per year between 1970 and 1975. Our own preliminary estimates suggest that during this same period between 20,000 and 25,000 additional Albertans will enter the labour force annually. The total labour force in Alberta at present is about 575,000 approximately 90,000 members of which are employed in forestry, fishing, and agriculture. Employment in these sectors has been decreasing. Therefore, the service sector plus mining, manufacturing and construction industries must provide the opportunities for additional Albertans entering the labour force.

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[2] Fourth Annual Review **"The Canadian Economy from the 1960's to the 1970's"**, September 1967, page 5.

4. Emigration

The White Paper supports the Carter Report which was: "skeptical that tax factors have been a major factor in emigration", and also refers to changes in conditions since the Carter Report which have made the United States a less attractive place to live.

The White Paper failed to recognize the significance of possible emigration at the regional level. For example, the petroleum industry employs thousands of highly specialized and highly trained individuals. If there is a recession in the provincial economy due to the White Paper proposals many Albertans will be forced to seek employment related to their skills which would mean emigration, and not necessarily to the United States. Many might prefer to emigrate to other countries. The combination of (i) increased tax rates in the middle income groups; (ii) the progressive nature of the proposed capital gains tax; and, (iii) the ultimate estate tax liabilities will certainly encourage many highly qualified Canadians to seek their livelihood elsewhere. We face the prospect of losing the highly skilled, and younger members of our labour force who have been schooled and trained for twenty years or more at considerable expense to the Canadian taxpayer. If our tax system drives them out of Canada, then we realize no tax revenues from them. The return on our educational investment in them is zero. This does not make good economic sense.

5. Standard-of-Living

Any significant decline in petroleum industry activity in Alberta as a result of implementation of the White Paper system could create a reverse multiplier effect or a provincial 'Elliott Lake type' situation affecting all levels of salaried and hourly rate employees. A great many salaried and hourly rated employees in Alberta have entered into long-term debt commitments such as mortgages on houses, which were predicated on the maintenance of a healthy economy. The adverse impacts resulting from the White Paper system would not be restricted to the 'well-to-do' group which is often referred to but never identified in the White Paper.

The White Paper frankly admits to the hazards of forecasting the impact of its tax system on the Canadian economy and government revenues, when it states:

> "It is always hazardous to forecast revenues from income taxes. Part of the risk is in economic forecasting, which must cover not only total incomes but their broad distribution. Moreover, corporate profits are more difficult to forecast than other variables . . . yet they are the basis of corporation income tax and affect capital gains substantially. These normal difficulties have been increased in recent years because substantial changes have been made in tax laws . . ."
>
> "The hazards of forecasting are increased when major changes are made in the tax structure. To estimate their effects it is necessary to know, to assume or to forecast on the basis of partial data, a number of factors that have not previously borne directly upon tax yields and are not reflected in tax statistics or other economic statistics. It is also necessary to forecast the reaction of taxpayers when confronted with new opportunities or new limitations on their behavior. These risks are particularly important in connection with the current program."

The White Paper admission regarding the hazards of forecasting is not reassuring. The White Paper has not provided any concrete evidence

to assure us that, under its proposed system, the economy would not be adversely affected. Because our own analysis indicates that the proposed system would have an adverse effect on our provincial economy, and therefore on the the welfare of all Albertans, we cannot support the major reform proposals in the White Paper as a package.

As expressed in our 1967 brief in response to the Carter Report:

> "Any taxation programs or other actions which serve to adversely affect these resource industries or other industries or services which they support in a total or partial way is certainly not in the Provincial or national interest. Creation of a 'recessed' area as a result of implementation of such programs could only result in a greater burden on Canadian corporate and individual taxpayers."

Chapter VII

THE IMPACT OF THE WHITE PAPER PROPOSALS IF IMPLEMENTED ON AGRICULTURE IN ALBERTA

The important contribution of agriculture to the Alberta economy and to Canada as a whole was explained in detail in our response to the Carter Report.[1] This contribution is highlighted in our current brief in order for the reader to appreciate the serious impact which implementation of certain White Paper proposals would have on this segment of our economy. The Chapter includes a discussion of the impact of specific White Paper proposals on agriculture, and concludes with our recommendations concerning these proposals.

A. IMPORTANCE OF AGRICULTURE TO THE ALBERTA ECONOMY

Occupied farm land makes up about 49 million acres or about 31 per cent of the total land area in Alberta.[2] During the post World War II period, the farm population in the Province has decreased. At the same time, the number of farms and farm employment have decreased, and occupied farm land has increased. The combination of these factors has resulted in a significant increase in the average size of farms, and reflects the increasing degree of mechanization of farming operations. These historical trends are summarized in the following tabulation:

	1951	1961	1966
Total Population (000)	940	1,332	1,463
Farm Population (000)	345	288	282
Farm to Total Population (%)	37	22	19
Farms (000)	84	73	69
Occupied Farm Land (millions of acres)	44.5	47.2	49.0
Average Size of Farms (acres)	527	645	705
Labour Force Employed (000)	n.a.	n.a.	91

n.a. — not available.

About 62 per cent of farms are operated by owners and the balance by owner-tenant or tenants. About two-thirds of Alberta farm operators are between the ages of 25 and 54, 30 per cent are age 55 and over, and only 3 per cent are under 25. In 1966, about 17 per cent of Alberta's total labour force was directly employed in agriculture. This was double the national average.

In 1966, net value of agriculture production totalled $630 million or 23 per cent of total value of industry production in Alberta.

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[1] Submission by the Government of the Province of Alberta Concerning the Report of the Royal Commission on Taxation, which was submitted to the Honourable Mitchell F. Sharp, Minister of Finance, on December 29, 1967.

[2] Statistics of Agriculture for Alberta 1967 and 1968: Publication No. 853-5, Department of Agriculture, Province of Alberta.

B. IMPACT OF WHITE PAPER PROPOSALS ON AGRICULTURE

The White Paper has proposed some tax reform measures which refer specifically to agriculture, and others which indirectly affect the industry.

The Government of Alberta supports the White Paper rejection of the Carter Commission proposal to put farmers on an accrual rather than cash basis. The cash basis has enabled the farmer to file his income tax return based on records of bank deposits and withdrawals.

Implementation of the proposal to tax capital gains would render the 'basic herd' concept obsolete. In addition, many economic farm units could be eliminated by the combined effect of taxation of capital gains at progressive rates and 1968 amendments concerning estate taxes, both of which are discussed in greater detail in Chapter III of this brief.

1. Basic Herd Concept

During and immediately after World War II, income tax rates increased rapidly. As a result, farmers who were engaged in livestock operations found that upon retirement their life savings were almost wiped out. During their working years, livestock herds had been accumulated. These herds were sold in a single taxation year when the owner retired. This meant that a large portion of the sales receipts were used to pay the income tax thereon. This caused a good deal of concern and after much investigation the 'basic herd' concept was developed in 1950.

Under this concept farmers have been permitted on application to maintain a basic herd of livestock which is treated as a capital asset. The cost of acquiring and raising animals comprised therein is a non-deductible capital expenditure, the proceeds from the sale of which produce a non-taxable capital receipt. In any given year, the farmer could reduce his deductible costs for tax purposes with respect to the acquisition of livestock and place that deduction in a special basic herd category. By reducing his cost, he paid more income tax in that particular year. At the time of his dispersal sale, he could deduct from taxable income the total value of the number of animals that had been built up in the basic herd.

There are many farmers in Alberta who could qualify under the 'basic herd' concept but, to the best of our knowledge, only a very small percentage have applied for and have obtained approval for a basic herd. If the basic herd provision were discontinued immediately, handicaps would be imposed on those farmers who do not have an approved basic herd.

Paragraph 5.49 points out that, since capital gains would be taxable in future under the White Paper taxation system, the 'basic herd' concept would be obsolete. Paragraph 5.50 states that the Government does not propose to tax capital gains that accrue before the new system begins, and consequently the fair market value of a farmer's basic herd at the beginning of the new system would be tax exempt. While this to some extent protects the relatively small number of farmers who are close to retirement, it is of no comfort whatsoever to farmers who have only recently commenced their working life. It certainly is no incentive to persuade other young men to take up farming as a career.

2. Combined Effect of Capital Gains Tax and Estate Taxes

Before commenting on the impact which these combined taxes will have on farming and ranching, it seems appropriate to comment on the historical practices of operating and disposing of such developments. After providing for his day-to-day necessities and expansion of his land and equipment holdings in order to remain competitive, generally speaking the farmer has very little, if any, income remaining to provide for his retirement.

As pointed out in our 1967 brief:

> "The normal farm operator acquires land for the purpose of making a livelihood and of enhancing the land's value through a life-long process of capital investment and the efforts of his labour. He is not a land speculator investing solely for the purpose of realizing a capital gain on the appreciation of land value. The normal farm operator hopes to develop a valuable capital asset that can be transferred from one generation to another as an economic unit. The productive value can be maintained only so long as there is incentive to work the land and the economic unit remains intact.
>
> In order for a farming operation to be economic, a certain sized unit-of-operation must be maintained. Although mechanization may be helping more farms to become economic, the cost of mechanizing them requires a larger-sized farm unit to support the increased cost of operation. As mentioned earlier, the average farm size in Western Canada is greater than for the nation generally and a higher percentage of Western Canada farming operations are taxable."

The farmer anticipates that at the time of retirement, the proceeds realized from the sale of his operation will provide for his retirement. As indicated in our 1967 brief, a portion of the proceeds realized from the sale reflects the impact of inflation rather than a gain in constant dollars.

The White Paper proposes to tax capital gains at marginal rates, including gains realized by the farmer on the sale of his farm upon retirement. No recognition is to be given to the decline in value of the dollar which has occurred. Since the average farmer would be dealing with a sizable receipt from such a sale, and since the White Paper suggests that the maximum rate of tax commences at $24,000, it is almost certain that he will be paying that maximum rate of tax on the bulk of his gain in spite of the suggested averaging provisions. This sale would normally represent the fruits of a life-time of effort which he had hoped to use to support his retirement years. If it is to be greatly depleted through taxation, somebody else, presumably the State, will have to assist him financially after retirement.

The combined effect of the White Paper capital gains tax proposal and estate taxes on the assets of a deceased farmer would result in confiscation of capital. Obviously, his widow would be unable to work the land. The elimination of estate tax between husband and wife is of little or no value to the deceased farmer's widow, as compared to a situation where a widow is left other types of assets which produce income. If the deceased farmer's widow did inherit the farm, she would likely have to sell at least a part of it to be able to invest in revenue producing securities. At the time of sale, she would be subject to the capital gains tax and hence her income would be substantially reduced.

As mentioned earlier, the average size of Alberta farms in 1966 was 706 acres. Commercial farms in Alberta, which are defined as those with agricultural product sales of $2,500 or more per year, averaged 1,050 acres in 1970 compared with 840 acres in 1966. Reasonably good farm acreage in Alberta is currently valued from $100 to $150 per acre. Therefore, the average farmer may have title to land valued from $100,000 to $150,000. In addition, investment in buildings, machinery, equipment, livestock, and poultry could range from $50,000 to $100,000. Many farmers have financed such investments on credit provided by commercial banks and equipment distributors. In addition, many have sizable outstanding mortgages on

their farms. Thus, the average farmer has a substantial capital investment in relatively non-liquid assets.

The combined effect of the White Paper capital gains tax proposal and estate taxes would destroy family farm units. In the past, a young farmer has gradually developed his own viable unit while continuing to work for his father and, to some extent, by inheriting part of his father's farm. However, the 1968 amended Estate and Gift Tax Act is considerably more severe on bequests to children than the one previously in existence. For the sons of a deceased farmer to obtain cash to pay the estate tax would probably require the sale of part of the land. Under the White Paper tax system, such a sale would then attract capital gains tax which must be paid from the sale of additional land. It is not practical to commence selling part of the acreage because the portion then left may not be an economic unit. As indicated in our 1967 brief, "the land only has productive value if the tax system preserves economic incentives." The tax on $300,000 of taxable estate is $89,000, with a 50 per cent rate on anything in excess of $300,000.

Under the old gift tax rules, a father could give his son $4,000 a year in cash or kind but this has now been cut in half. He also could have transferred an additional amount of $5,000 per year every year at a gift tax of 10 per cent, reaching a maximum of 28 per cent on anything over $1,000,000 in each year. The rates of gift tax on taxable gifts now start at 12 per cent up to $15,000 and are 75 per cent on taxable gifts over $200,000. The new percentages also apply to the cumulative gift sum.

The White Paper has suggested that the payment of inheritance tax could be extended over a five-year period but this in turn involves the cash payment of interest costs. Unfortunately, most farmers find that cash is a very short commodity.

3. Capital Cost Allowances

Under present rules and regulations, farmers may claim capital cost allowance on a straight line basis, calculated on each individual piece of equipment. If at any time they should sell that equipment at a price in excess of the net taxable book value, such excess constitutes a non-taxable capital gain. Under the White Paper proposals, that gain will now be taxed at full rates.

The White Paper suggests that farmers should move to the declining balance basis for capital cost allowance so that, if they should sell an asset in excess of its net taxable book value, such excess can be used to reduce the book value on his other equipment. This results in no tax being paid at that time but if he gives part or all of the equipment or sells it when he retires, he will be subject to tax at marginal rates through the recapture of capital cost allowance.

A major part of the fixed assets of a farming operation is represented by investment in land which is non-depreciable for tax purposes. In other words, the situation of the farmer is quite different from that of the average industrialist whose investment is essentially in buildings and equipment which are depreciable for tax purposes.

4. 'Valuation Day' Proposal

Under the proposed White Paper tax system, farmers and ranchers, like other taxpayers, would be forced to value their assets on valuation day. In view of the present depressed market outlook for grain in particular, which has adversely affected financing or sale of farm operations, valuation

day could occur at a time when farmlands are worth a minimal value and, in certain instances, probably less than original cost in terms of real dollars. This example illustrates the inherent weaknesses of the 'valuation day' concept. The valuation day proposal also raises problems in connection with the tax treatment of the basic herd. These problems are not discussed in the White Paper. Many of the general comments about valuation day discussed in Chapter III apply to assets owned by farmers and ranchers.

5. Possible Break-up of Economic Farm Units

Over the years, various persons in responsible positions have attempted to give certain relief to classes of taxpayers in order to promote the economic health of Canada as a whole. Attention has been paid to the farmers. Certain provisions were put into the Income Tax Act and its predecessor, the Income War Tax Act, to pursue these economic objectives. The White Paper authors apparently have decided that the objectives of these people, who were very close to the situation, are unsound or no longer valid, and are therefore proposing to sweep aside the careful thought of their predecessors.

Implementation of these proposals will surely lead to gradual disintegration of economic farm and ranch units and raises valid concern that this vital segment of our economy may eventually be owned by foreign individuals or corporations which have a different world-wide tax position than the present Canadian owners. Implementation would also impair personal initiative and contribute to the further departure of young farm children from the farm to urban life. Finally, it could discourage existing farmers from incurring additional financial risks required to expand their operations to benefit from economies of scale.

The Carter Commission made the following comment relevant to this matter:[8]

> "The taxation of farming income must take into consideration the special characteristics of this natural resource industry, the vagaries of nature and markets, the prevalence of small individual operators, and the close relationship of personal and business activities. On the other hand, if equity is to be achieved, the importance of these special characteristics must be considered in comparison with those encountered by taxpayers in other lines of endeavour."

During the years that the Carter Commission was preparing its report, there was a world shortage of grain and Canada was making substantial export sales. At the present time, as in the 1930's and during World War II, surplus inventories have developed. The present situation will change but in the meantime more Canadians may migrate from farm and other rural communities to the cities.

The Government of Alberta is concerned that the implementation of the White Paper proposals could lead to the break-up of economic farm units and accelerated migration of farm residents.

6. Other White Paper Proposals which would be Unattractive to Agriculture

The opportunity to write-off capital losses against other taxable income would be of no benefit to most farmers who would have no other income against which to charge such losses. Also, the proposed averaging formula

[8] Volume 4, Chapter 25, page 440.

is unduly complex, as admitted in the White Paper. Finally, the basis for taxing capital gains on principal residences would be unfair, for reasons which are detailed in Chapter III.

C. SUMMARY AND RECOMMENDATIONS

The Western Canadian farmer is presently faced with:

(a) a severe reduction in the marketability of his wheat; (b) little or no increase and, in some cases, an actual reduction in the sale price of his product; and, (c) increasing costs for all products and services that he must acquire, including labour and interest charges. As a result, his operation is subject to a cost-price squeeze which is aggravated by the overall inflation in the economy.

To these problems, the White Paper proposals, if implemented:
(a) will add taxes arising from the abolition of the basic herd; (b) will increase taxes arising from the sale of farming units on retirement; (c) will add taxes on disposals of fixed assets which previously created a non-taxable gain; (d) will add taxes on the sale of any mineral rights (in excess of valuation date value) which are owned and attached to farmlands, and on lease rentals received in connection with mineral rights; and, (e) will increase liabilities on taxable income as a result of higher personal tax rates to be applied to the middle income group.

The Government of Alberta recommends that:

1. The 'basic herd' concept should be retained and capital gains therefrom should not be subject to tax;

2. The straight line basis of capital cost allowance should be continued and any gain therefrom should bear no tax;

3. Since the capital gain from the sale of farm land represents a high degree of inflation, such gains should be tax exempt. This is consistent with our overall recommendation, as discussed in Chapter III, that Canada should not have a capital gains tax; and,

4. Farmers should be permitted a special allowance by gift or bequest of $50,000 per child, with no tax when the gift is in the form of a farm unit or part of a farm unit. The allowance should be reviewed every five years.

Chapter VIII

IMPACT OF THE WHITE PAPER RECOMMENDATIONS ON THE ALBERTA PETROLEUM INDUSTRY AND ON THE FISCAL CAPACITY OF THE PROVINCE OF ALBERTA

This Chapter indicates the effect on the petroleum industry of specific White Paper proposals relating to the mineral industries, if implemented. Reference is also made to the effects on the industry of the proposal relating to taxation of capital gains, which is discussed in detail in Chapter III.[1] This discussion is followed by a quantitative analysis of the potential impact of these White Paper proposals on the fiscal capacity of the Government of Alberta.

In order to place these matters in proper perspective, the Chapter begins with a very brief discussion of the importance of the industry to the Alberta economy.

A. ECONOMIC IMPORTANCE OF THE PETROLEUM INDUSTRY

The very sizable contributions of the Canadian petroleum industry to the Alberta economy and to the Canadian economy were discussed in detail in our 1967 Submission.[2]

Petroleum and natural gas currently provide about two-thirds of Canada's total energy supply. Approximately 50 per cent of the petroleum and 100 per cent of the natural gas used in Canada are obtained from domestic sources. An attractive political and economic environment must be maintained to encourage continued development of this vital industry.

The Province of Alberta is the major source of existing domestic petroleum and natural gas supply, containing over 88 per cent of presently-known petroleum resources in Canada and nearly 80 per cent of the natural gas. The petroleum industry is a major sector of the Alberta economy. For example, in 1969 it accounted for over 30 per cent of the Province's total net value of production by primary industries.

In addition, the petroleum industry has been the main source of direct revenue for the Government of Alberta. In 1960, the sale of crown reserves, royalties, fees and rentals on petroleum and natural gas contributed just over $100 million to general revenues of the Province. In 1969, this figure amounted to $270 million, or 37 per cent of total net general revenue.

It is obviously desirable to the Federal Government, as well as the Alberta Government, to preserve the economic stability of the petroleum industry in our Province. Economic growth not only benefits individuals and corporations but all levels of government as well. As the tax base enlarges, so does the fiscal capacity of government. Alberta's economic

[1] The petroleum industry would also be affected by implementation of the proposal for integration of shareholder and corporate income tax, which is discussed in Chapter IV.

[2] Submission by the Government of the Province of Alberta Concerning the Report of the Royal Commission on Taxation, December 1967, Chapters II and III.

growth and development in recent years has relieved the Federal Government of certain regional responsibilities and reduced the overall burden of the Canadian taxpayer. Regardless of whether the Government of Alberta is able to maintain such a relatively low level of financial dependence on the federal government in the future, Alberta requirements can be minimized by preserving the economic stability of the Province's key industries — agriculture and petroleum.

The long-term outlook in domestic and export markets for the Canadian petroleum industry is encouraging, as reflected in recent studies available to the Alberta and Federal Governments.[8] In order to take advantage of these prospective markets, it will be necessary to provide an attractive investment climate for new domestic and foreign risk capital, as well as the net cash flow generated from petroleum industry operations, which constitute a very important source of funds. Under these circumstances, an increasing share of exploration and development expenditures will be directed to areas under Federal Government jurisdiction, as well as to some of the other provinces.

A healthy investment climate will be fostered by competitive and stable regulations, including those relating to taxation. As indicated in our 1967 submission, any taxation programs, or other actions which adversely affect the resource industries or services which they support, are certainly not in the Provincial or national interest. Creation of a depressed area could only result in a greater financial burden on Canadian corporate and individual taxpayers.

B. IMPACT OF THE WHITE PAPER PROPOSALS ON THE PETROLEUM INDUSTRY

1. Total Tax Burden of the Petroleum Industry

Before dealing with the specific proposals relating to the petroleum industry, we would like to take exception to the apparent misapprehension of the authors of the White Paper in connection with the total burden of taxation of the petroleum industry.

Paragraph 5.24 of the White Paper states that:

> "The government has concluded that special rules are still needed for the mineral industry, but that they should be revised substantially to ensure that really profitable projects bear a fair share of the burden of taxation. . . . the government feels that the exploration for and development of minerals still warrant some support in a form more directly related to this activity than has been the case with past depletion. It is believed that support on a less-generous scale should suffice for this purpose."

The White Paper also states that:

> "The mineral industries enjoy special tax benefits that have existed for many years but that are unnecessarily costly and inefficient. Assistance to mineral exploration and development must do its intended job in a more direct way that is less costly in terms of revenue."

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[8] See (1) **Energy Supply and Demand in Canada and Export Demand for Canadian Energy 1968 to 1990**, National Energy Board, Ottawa, 1969, and (2) **Prospective Demand for Canadian Crude Oil Under Alternative Industry and Canadian-United States Government Policies** prepared by Foster Economic Consultants Ltd., Calgary, and Foster Associates, Inc., Washington, D.C., October 1969.

". . . However, the special rules should be revised substantially to ensure that really profitable projects pay a fair share of the national revenues, as other industries do, and that the inducements offered are efficient."

These statements imply that the mineral industries do not carry their fair share of the total tax burden. The White Paper seems to interpret national revenues in the narrow sense of corporate income tax. It should have viewed tax incentives in terms of the total contribution of the petroleum industry to governmental revenues. When consideration is given to all forms of governmental revenues, it is evident that the petroleum industry carries a very substantial burden.

For example, the industry contributed about $270 million to the Province of Alberta in 1969 in the form of royalties, fees, rentals and the purchase of government-owned mineral rights. The industry has also made important contributions to government revenues in other provinces.

The White Paper also failed to consider the tax burden of the mineral industries in terms of true horizontal equity and tax neutrality. For example, the risks of petroleum exploration are so unusual that the form of taxation must give recognition thereto, to avoid discriminatory and therefore unequal tax burdens. Equal treatment and equivalent tax burden requires differential tax provisions according to risk classifications. Differential taxation of the mineral industries is required to provide tax equity and neutrality. Also, the preferential treatment of the Canadian manufacturing industries by means of tariff barriers against foreign products must be considered in any study of equity and neutrality.

Oil and gas producers bear the unique risk that the expenditure of exploration funds may result in discovery of little, if any, reserves. A company which invests in exploration does not know in advance how much it will be required to invest before it finds oil or gas. Oil and gas producers also face a greater degree of regulatory risk than manufacturers. Because of these unique risks, special tax provisions are necessary in order to avoid an unfair tax burden on the petroleum industry.

2. Specific White Paper Proposals Relating to the Petroleum Industry

The White Paper admitted that a number of its tax reform measures, if implemented, could adversely affect the minerals industry in a number of ways, including:

(i) after-tax rate of return;
(ii) some decline in foreign investment; and,
(iii) some reduction in capital expenditures.

The specific proposals bearing on the petroleum industry relate to (a) exploration and development costs, (b) depletion allowance — operators, (c) depletion allowance — non-operators, and, (d) the new mines three-year tax exemption. In addition, certain other proposals will adversely affect the overall investment climate and the ability to raise capital. These proposals include taxation of capital gains and integration, which are discussed in Chapters III and IV, respectively.

Many briefs submitted to the Minister of Finance by the petroleum industry undoubtedly will discuss the implications of these tax reform proposals in detail. Therefore, a similar detailed discussion in this Government of Alberta submission seems unnecessary. However, a summary is presented in order to place in perspecitve an analysis of the collective impact

the proposals could have on future petroleum industry investment in Alberta and contributions to the revenues of the Province.

(a) **Exploration and Development Costs**

The White Paper appropriately recognizes the need for immediate deduction of exploration and development costs plus the provision for carry forward. However, full claiming of such deductions would be limited to taxpayers meeting the 'principal business test'.

Taxpayers who do not meet this test would be allowed to set up an asset class for exploration and development expenses and deduct the maximum of:

(i) their incomes from mineral properties before deduction of such expenses; or,

(ii) 20 per cent of the net book value of the asset class.

The prospect of prolonged amortization of unsuccessful exploration expenses reduces the incentive for Canadian investors to participate in development of the petroleum industry. U.S. investors are not subject to this restriction.

For these reasons, the 'principal business test' should be abandoned.

(b) **Depletion Allowance — Operators**

The existing **net** depletion allowance is criticized in the White Paper on two bases:

(i) it can be claimed against profits throughout the life of a successful venture regardless of whether further exploration is undertaken; and,

(ii) deduction of exploration costs **reduces** the depletion allowance and may, therefore, actually inhibit exploration incentive in some cases.

To correct these claimed 'inefficiencies', the White Paper proposes that depletion allowance be **earned.** For every $3 of eligible expenditures after publishing of the White Paper, the right to $1 of depletion allowance would be earned. The cost of acquiring mineral rights would **not** be considered an eligible expenditure. During a five-year transition period to the end of 1975, net depletion allowance could continue to be claimed on production from existing properties without having to be earned.

The Government of Alberta agrees with the basic concept of encouraging future exploration. However, we are concerned that the proposed change will fail to achieve the desired objective.

The fact that exploration for petroleum is a high-risk venture has already been discussed. Depletion allowance enhances the value of successful exploration and indeed renders certain marginal operations commercially viable and, therefore, increase overall recovery of hydrocarbons.

The opportunity to claim depletion allowance is a major economic consideration in **pre-investment** decisions. Because the productive life of many oil and gas reservoirs is fifteen to twenty-five years or longer, the White Paper proposal to place depletion allowance on an earned basis after a short five-year transition period will have an adverse, **retroactive** effect and will immediately **reduce the value** of existing Canadian oil and gas reserves. Investment in these reserves was made in good faith in reliance upon the established tax system. Capital already committed is immobile and unable to avoid inequitable tax burdens. If the relatively-short transitional

period was introduced as legislation, future net earnings would be reduced below the original estimated level, which was based on past government action. Investor confidence will be impaired.

Restricting depletion allowance to one-third of eligible expenditures would also result in **increasing the direct tax burden** on producing income. Therefore, investment would be discouraged and regional economic development inhibited.

The Government of Alberta believes the opportunity to claim depletion allowance for the lifetime of a successful venture is justified. It creates additional cash capital for future investment, and provides added incentive to pre-investment considerations. However, **net** depletion allowance is not an efficient tax provision for encouraging exploration.

It is interesting to note that, after extensive reappraisal of depletion allowance, the United States retained the **gross** method of calculation but did reduce the percentage allowed from 27½ per cent to 22 per cent. Canadian companies compete with United States companies for exploration funds in many of the same capital markets and should, therefore, be accorded comparable tax treatment. In order to provide exploration incentive and maintain a favourable investment climate in Canada, we **recommend** the following alternatives:

(i) **Assuming Rejection of 'Earned' Depletion**

Implement a **gross** depletion allowance, at least on a partial basis. (This would eliminate the inefficient aspect of net depletion.)

(ii) **Assuming Implementation of the 'Earned' Depletion Concept**

Include the cost of acquiring Crown mineral rights as an **eligible** expenditure **if** an 'earned', or, combined 'gross and earned' depletion allowance system is implemented. (Such acquisition costs are a necessary part of exploration and development.)

Reduce the earning requirement. (Many industry submissions suggest a $1 allowance for each $2 or eligible expenditure rather than the proposed $3.)

Extend the **transition period** to at least 10 years.

Rejection of the earned depletion concept would be by far the preferable alternative.

(c) **Depletion Allowance—Non-Operators**

The White Paper proposes repealing the present 25 per cent depletion allowance for non-operated production or royalty income. This proposal would be **retroactive** and unfair to present royalty holders since their investment royalty income was determined on the basis of assumed continuation of existing depletion allowance provisions.

(d) **New Mines—Three-Year Tax Exemption**

The White Paper proposes to "phase out the present three-year exemption for new mines." Instead, accelerated write-off of mining machinery and buildings, as well as exploration and development expenditures, are proposed in order to recognize the risk associated with new mining ventures. However, the proposed acceleration of capital cost allowances will not compensate for the loss of the three-year tax exemption.

This suggested tax revision, coupled with the earned depletion allowance proposal, would have an extremely adverse impact on future development of the Athabasca oil sands.

Oil sand projects require huge pre-production expenditures (i.e., $200 to $300 million) but do not require on-going exploration and development outlays needed to 'earn' the proposed depletion allowance.

At present, oil sands development has only marginal economic attraction and is limited to companies with substantial capital and technical resources. Participants in the Syncrude Canada Ltd. project indicate that the combined effect of removing the three-year tax exemption and earned depletion requirements will likely 'kill' their project.

This possibly greatly concerns the Government of Alberta. Apart from the presently-operating Great Canadian Oil Sands plant, Syncrude is the only company ready to undertake an oil sands project. The loss of such potential development would be serious for three reasons:

(i) It would reduce the availability of **known** hydrocarbons which will be needed to help satisfy rapidly-growing energy requirements in North America;

(ii) it would severely impair prospective economic growth in the Province of Alberta; and,

(iii) it would eliminate royalties and income tax revenues received by governmental authorities.

We **recommend** tax provisions be designed which will adequately facilitate economic construction and operation of oil sands and other heavy oil projects.

(e) Taxation of Capital Gains

This White Paper proposal was discussed in considerable detail in Chapter IV. Even with present tax incentives, the petroleum industry has difficulty in raising required debt or equity capital in Canada. Implementation of a capital gains tax can only intensify this problem.

Since the maximum personal rate of 50 per cent would not be reached until the end of the five-year transition period under the proposed White Paper system, investment in equities would be relatively unattractive, particularly since investors in this industry are motivated by prospective capital gains.

Because of higher marginal taxes, the majority of Canadian investors in widely-held corporations would be at a disadvantage compared with their U.S. counterparts, particularly during the transition period. However, a substantial difference would continue to exist even after transition.

The proposed tax treatment of capital gains from the sale of shares of closely-held Canadian corporations could have the following effect:

(i) if Canada is able to negotiate international treaties to extend the proposed Canadian tax rate to include such foreign investment in Canada, new foreign capital for such investments would be greatly discouraged; or,

(ii) if Canada is not able to negotiate these international treaties, foreign investors would have a considerable advantage over Canadian investors.

The above implications to investment in the Canadian petroleum industry of a capital gains tax contributed to our overall recommendation that a capital gains tax be rejected at this time.

C. ADVERSE EFFECT UPON THE GOVERNMENT OF ALBERTA'S FUTURE FISCAL POSITION

The Whie Paper proposals, if implemented, will seriously affect the Canadian petroleum industry, an important source of revenue for the Government of Alberta. The industry contributes revenue in many direct and indirect forms, including: cash prices, acreage rentals, royalties, non-income taxes, plus personal and corporate income taxes. Revenue cutbacks by the petroleum industry as a result of implementation of these proposals will commensurately reduce Alberta Government revenues.

The Government of Alberta is deeply concerned over the outlook for its future revenues in relation to anticipated expenditures should these proposals be adopted. Until the fiscal year ending March 31, 1966, Alberta's revenues exceeded expenditures. For the fiscal year ended March 31, 1970, a negative balance of $34 million was forecast and a further deficit of $113 million is estimated for the current fiscal year. Without increases in revenue from existing sources, access to new sources of revenue and/or reduced expenditure programs, the situation will worsen. Implementation of various White Paper proposals will reduce the fiscal capacity of the Government of Alberta and, as a result, will further aggravate this serious problem, particularly since revenues are relatively sensitive and expenditures relatively insensitive to changes in economic activity.

Nearly 70 per cent of Alberta's net revenue comes from direct revenues received from the petroleum industry and corporate and personal income taxes.

The main purpose of the analysis summarized in the balance of this Chapter is to illustrate the impact which the major White Paper proposals, as related primarily to the petroleum industry, would have on revenues accruing to the Alberta Government. In order to quantify these possible effects, a number of reasonable assumptions have been made. The estimates, therefore, provide an order-of-magnitude indication of the possible effects. More specifically, the material deals with the following subjects:

1. projected investment under continuation of present tax regulations;
2. projected investment under the proposed White Paper taxation system;
3. major sources of net general revenue;
4. direct revenue from the petroleum industry;
   (a) projected under existing tax regulations;
   (b) projected under the proposed White Paper taxation system; and,
5. taxes on income—personal and corporate.

1. Projected Investment Under Continuation of Present Tax Regulations

Many factors combine to influence petroleum industry investment decisions. Uncommitted capital is mobile and, assuming tax policy to be known and stable, the available funds flow to areas where they can be employed most profitably relative to the risks involved. Factors of more immediate consequence, such as the occurrence of major geological plays and the nature of prevailing economic conditions, have an important bearing on such decisions.

Although significant year-to-year changes in these factors may cause periodic anomalies, there has been a reasonably predictable relationship

between revenue receipts and investment in the **conventional** segment of the petroleum industry.

For example, in Alberta, the ratio of capital investment to revenue has shown the following relationships over the past six years:

	Capital Investment[4] ($ MM)	Revenue[5] ($ MM)	Investment/ Revenue (Per Cent)
1964	410.8	652.4	63.0
1965	497.7	704.3	70.7
1966	501.6	791.9	63.3
1967	584.9	911.8	64.1
1968	592.0	1,026.5	57.5
1969	638.5	1,129.5	56.5

A gradual downward trend in the investment/revenue relationship is anticipated over the next 10 years for several reasons:

(i) revenues from crude oil, natural gas, natural gas liquids and sulphur should increase steadily because of strong domestic and export demand for these commodities;

(ii) exploration and development activity will approach maturity in Alberta over the next decade, with a corresponding impact on investment; and,

(iii) prospective new supply areas in the Territories, Arctic and offshore will attract increasing amounts of investment capital.

Projections of industry revenue from Alberta reserves were based on recent studies of the demand outlook for Canadian petroleum products.[6] Revenue is expected to increase to $2.4 billion in 1980, as shown below. For purposes of this analysis, the investment/revenue relationship was assumed to decline to 45 per cent by 1980. on the basis of this analysis, projected investment should increase rapidly to $1,030 million in 1975, and level off to about $1,080 million in 1980.

	Projected Capital Investment ($ MM)	Projected Revenue ($ MM)	Assumed Investment/ Revenue (Per Cent)
1970	660	1,200	55
1975	1,030	2,050	50
1980	1,080	2,400	45

[4] Includes net cash expenditures for exploration, development drilling, field equipment. secondary recovery and pressure maintenance projects, and natural gas plant construction.

Source: Canadian Petroleum Association, 1968 Statistical Yearbook.

[5] **"Total Value of Sales".**
Source: 1968 Canadian Petroleum Association annual yearbook.

[6] **Prospective Demand for Canadian Crude Oil Under Alternative Industry and Canadian-United States Government Policies (1969-1983)**, Foster Associates, Inc., Washington, D.C. and Foster Economic Consultants Ltd., Calgary, Alberta, October 1969.

Energy Supply and Demand in Canada and Export Demand for Canadian Energy 1966-1990, National Energy Board Staff, Ottawa, 1969.

In addition, further development of synthetic supplies in the Athabasca oil sands is expected, assuming the White Paper proposals are not enacted. For example, Syncrude Canada Ltd.[7] has received authorization from the Government of Alberta to commence oil sands production about mid-1976. To date, the company has expended $30 million on research and development. Estimated plant investment is approximately $200 million.[8] A further $50 to $100 million will be required for a plant to provide the electric generating needs of Syncrude's project and other provincial requirements.[9]

Prior to 1980, further synthetic development could require additional investment in the order of $100 to $300 million.

Total petroleum industry investment in Alberta between 1970 and 1980 under continuance of existing tax regulations is projected to range from $10 to $11 billion, i.e., roughly $10 billion conventional and $250 to $600 million synthetic. Another $10 billion will be spent elsewhere in Canada over this period.

2. Projected Investment Under the Proposed White Paper Taxation System

Petroleum industry investment under tax reforms proposed in the White Paper will inevitably be lower than if present tax regulations were to continue. A reasonable approximation of the impact on investment is predictable even though precise quantification is not possible. Analysis showed that under the proposed White Paper system:

(i) the general investment climate will be less favourable;

(ii) the incentive to invest in the Canadian petroleum industry will be reduced; and,

(iii) the industry's ability to generate capital internally will be impaired.

As a result of these factors, potential investment in the conventional segment of the petroleum industry could be reduced by at least 10 per cent to 25 per cent, or by at least $1.0 to 2.5 billion between 1970 and 1980.

In addition, further development of the Athabasca oil sands would certainly be abandoned by industry if the White Paper tax reform proposals affecting such a project are implemented. This would mean cancellation of potential investment of $250 to $600 million.[9]

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[7] Participants in Syncrude include: Imperial Oil Limited, Cities Service Athabasca, Inc., and Atlantic Richfield Canada Ltd., 30 per cent each, and Gulf Oil Canada Limited, 10 per cent.

[8] Submission by Syncrude Canada Ltd. with respect to Proposals on Tax Reform, March 1970.

[9] Imperial Oil Limited has suspended its heavy oil research operations at Cold Lake, Alberta, and Amoco Canada Petroleum Company Ltd. recently cancelled a deferred application to the Alberta Oil and Gas Conservation Board for an 8,000 barrels per day oil sands project.

3. Major Sources of Net General Revenue

In the fiscal year 1969, revenues received directly from the petroleum industry plus personal and corporate income taxes were the most important revenue categories for the Government of Alberta, as shown below:

Type of Revenue	Amount[10] ($ MM)	Share of Total (Per Cent)
Taxes on:		
Income	182.4	25.0
Consumption	85.7	11.7
Assets	11.3	1.5
Privileges, Licenses and Permits	45.2	6.2
Petroleum and Natural Gas Revenues	269.9	37.0
Government of Canada	10.3	1.4
Other Revenue	124.8	17.1
Total	729.6	100.0

Between 1960 and 1969, total net general revenue in the Province rose from $245.5 million to $729.6 million. Throughout this period, direct revenue from petroleum and natural gas, i.e., crown reserve sales, royalties, fees and rentals, was the most important source. In the income tax field, increased tax rates, coupled with increased federal abatements, have greatly augmented revenue from this source in recent years.

'Other revenue' includes payments from the Federal Government for post-secondary education and receipts from Alberta Liquor Control Board operations, both of which contributed to the increased importance of this category.

An attempt to assess the possible impact of certain White Paper proposals on future Government of Alberta revenues is presented in the following analysis. Attention is focused on direct revenue from the petroleum industry and income taxes. No attempt is made to assess the impact on 'other revenue' because it would be highly speculative to project federal payments. In any event, the Government of Alberta takes the position that we are prepared to surrender these payments in favour of access to a major portion of the income tax field, large enough to finance our constitutional responsibilities as a province without domination or supervision by the Federal Government.

4. Direct Revenue from the Petroleum Industry

(a) Projected Under Existing Tax Regulations

In recent years, **crown reserve** sales, i.e., petroleum industry acquisition of crown-owned mineral rights, accounted for about 15 to 20 per cent of total annual capital investment by the industry. The lower portion of this range occurred in the most recent years. Based on investment projections shown earlier and a government revenue-to-industry investment relationship of 15 per cent, crown reserve sales would yield $99 million in 1970, $155 million in 1975 and $161 million in 1980.

[10] Estimates prepared by the Budget Bureau, Provincial Treasury Department, Government of Alberta, for 1969-70 fiscal year, and March 31 (see Table A-1 for further detail).

Royalties have consistently averaged close to 10 per cent of total industry revenue for several years. Assuming this relationship continues, royalties based on projected revenues shown earlier will amount to $120 million in 1970, $205 million in 1975, and $237 million in 1980.

During the past five years, Provincial Government revenues from **fees and rentals** have ranged from $53 million to $61 million. This level of land retention by industry will likely be maintained through 1975. A decline is anticipated thereafter as exploration and development in Alberta reaches maturity. Fees and rentals are estimated at $55 million for 1970 and 1975, declining to $45 million in 1980.

The tabulation below summarizes the foregoing projections:

	1970	1975 ($ MM)	1980
Crown reserve sales	99	155	161
Royalties	120	205	237
Fees and rentals	55	55	45
	274	415	443

Alberta Government revenue received directly from the petroleum industry would total over $4 billion between 1970 and 1980 based on these projections.

(b) **Projected Under the Proposed White Paper Taxation System**

Tax reform proposals, which will adversely affect petroleum industry investment, will affect each component of direct petroleum and natural gas revenue.

The petroleum industry has immediate and direct control over expenditures for the acquisition of crown reserves, as well as fees and rentals for land retention. Crown reserve sales would be most severely affected because of reduced capital availability and reduced investment incentive resulting from the collective impact of 'earned' depletion allowance, integration, and capital gains tax proposals. However, the proposal that the cost of acquiring mineral rights **not** be allowed as an 'eligible' expenditure for 'earned' depletion purposes would have the greatest impact on future cash bids for crown reserves.

The incentive to acquire additional crown reserves could be further depressed during the five-year transition period as industry strives to obtain the maximum benefit remaining from existing net depletion allowance provisions by minimizing all exploration and development expenditures. If the petroleum industry reacted in this manner, an up-surge of exploration and development activity could follow the transition period in an attempt to pick up the backlog and minimize future corporate income tax exposure by claiming maximum earned depletion allowance. However, cash bids for crown reserves would not rebound accordingly because the cost of acquiring mineral rights would not be allowed as an eligible expenditure.

The combined effect of these negative factors could reduce revenues from crown sales as much as 25 per cent or 50 per cent from levels under continuation of existing tax legislation. Because costs of acquiring crown

acreage would not be eligible, it seems reasonable to expect that the reduction would be greater here than overall, in relative terms. The comparative figures are:

	Crown Sales Under Existing Legislation	Reduction in Crown Sales Revenues Under White Paper Proposals Assuming:	
		25% Reduction	50% Reduction
	(millions of $)	(millions of $)	
1970[11]	99	25	50
1975	155	39	78
1980	161	40	81

Over the 1970-80 period, the potential revenue loss from this source could total $390 to $780 million.

The impact on **fees and rentals** would likely not be as severe. However, reduced industry incentive would undoubtedly result in reduced acreage holdings. Reductions of $5 million in 1970, $10 million in 1975, and $15 million in 1980 seem reasonable, or roughly $110 million in total for the period 1970-80.

Royalties would likely be essentially unchanged in the early part of the projection period. However, longer term production levels would be lower because of reduced exploration and development. Such a reduction in activity could have a compounding effect. Potential U.S. reliance on Canada as a future source of energy supply would be restrained and alternatives sought. Therefore, a 5 per cent reduction in royalties is projected for 1975, rising to 10 per cent in 1980, resulting in Provincial Government revenue losses of $10 million and $24 million, respectively. No loss is anticipated for 1970. Based on these projections, losses in revenue from royalties would amount to $105 million between 1970 and 1980.

In summary, implementation of proposed tax reforms could cause the Government of Alberta to lose between $600 million and $1 billion of potential revenue from the petroleum industry over this period.

5. Taxes on Income—Personal and Corporate

The extent to which the existing tax system would be completely overhauled makes it virtually impossible to analyze and place in total perspective the regional and national economic repercussions that could occur.

The White Paper generally concludes that the proposed tax system will yield higher personal and corporate taxes. The following analysis shows the nominal ameliorating effect such increases would have in Alberta relative to prospective losses in revenue from the petroleum industry.

For purposs of illustration, certain calculations presented in Chapter 8 of the White Paper were accepted as a basis for assessing the impact on Provincial revenues from income taxes between 1970 and 1980. In order to compare increased revenues from income taxes with losses in direct revenue from the petroleum industry, certain assumptions are necessary. First year increases are assumed to occur in 1970 and fifth year increases in 1974. Projecting increases for the year 1980 at roughly $20 million, income tax revenue increases in Alberta under the proposed vis-a-vis the present tax system would total approximately $125 million through 1980.

[11] For purposes of illustration, it is assumed that the proposed system is implemented in 1970.

Income Tax	Increased Revenue First Year[12] ($ MM)	Fifth Year Multiplier[13] (5th yr./ 1st yr. Ratio)	Increased Revenue Fifth Year ($ MM)
Personal	1.3	3.00	3.9
Corporate	2.0	2.74	5.5
Total	3.3		9.4

Increases in income tax revenue of this magnitude would not even come close to offsetting possible revenue losses from the petroleum industry of $600 million to $1 billion.

D. SUMMARY

The White Paper recommendations that will adversely affect the petroleum industry and, consequently, Provincial Government revenues accruing therefrom are viewed with great concern by the Province of Alberta. Paragraph 2.33 of the White Paper states that the Federal Government wishes to avoid causing any significant change in provincial revenues through its changes in exemptions and rates. If this is a position that the Federal Government is prepared to take regarding all revenues accruing to the Provincial Government, then the White Paper proposals relating to taxation of the mineral industries must be changed.

Prospective petroleum industry investment in Alberta over the next decade could be reduced by total amounts ranging from $1.25 to $3.10 billion.

The Government of Alberta must point out most emphatically that, should the Government of Canada implement the White Paper proposals discussed in this Chapter of our brief, they will have a very adverse effect on the petroleum industry.

Over the next few years, an increasing portion of the industry's exploration and development effort will shift to prospective new hydrocarbon supply areas in the Yukon and Northwest Territories, the Canadian Arctic and Eastern Canada offshore. Therefore, the flow of direct non-income tax revenue to the Federal Treasury should rise accordingly. However, tax provisions affecting the industry will have a major bearing on the incentive for exploration and development in these areas of extremely high-cost operation.

We would like to caution the Federal Government that, unless its taxation proposals are competitive and stable, both in the short- and long-term, oil and gas exploration in regions under Federal jurisdiction will slow down. As pointed out earlier, uncommitted domestic and foreign capital is mobile. Incentives to Canadian mineral industries must be as good

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[12] Chapter 8, Table 14 of the White Paper shows the Provincial revenue effect of proposed changes increasing Alberta's share of personal and corporate income taxes by $3.3 million in the first year under the proposed system.

[13] The impact in the fifth year was determined by multiplying a 'national' fifth year/first year ratio by first year increased revenue estimates for the Province of Alberta.

This 'national' multiplier ratio was calculated from data contained in Tables 15 and 16 of the White Paper.

	First Year ($ MM)	Fifth Year ($ MM)	Ratio
Personal	— 35	+ 70	3
Corporate	+205	+560	2.74

or better than those available in other countries. The White Paper recognized this fact when, in connection with corporation tax, it stated:

> "further increases would be damaging to our economic development and competitive ability, making it more attractive to locate industries in other countries."

Table A-1

NET GENERAL REVENUE[1]
Government of Alberta

TYPE OF REVENUE	1960 $ MM	1960 % of Total	1964 $ MM	1964 % of Total	1969[2] $ MM	1969[2] % of Total
Taxes on Income						
Personal	—		27.8		125.7	
Corporate	—		23.5		56.6	
Total	—	Nil[3]	51.3	13.4	182.4	25.0
Taxes on Consumption						
Amusements, etc.	0.8		1.0		1.9	
Gasoline and Fuel	27.1		41.0		77.8	
Tobacco	—		—		6.0	
Total	27.9	11.4	42.0	11.0	85.7	11.7
Taxes on Assets						
Business	2.1		2.7		4.3	
Estate	—		—		7.0	
Total	2.1	0.8	2.7	0.7	11.3	1.5
TOTAL TAXES	30.0	12.2	96.0	25.1	279.4	38.2
Privileges, Licenses and Permits	24.8	10.1	30.8	8.0	45.2	6.2
Petroleum and Natural Gas Reserves						
Crown reserve sales	44.1		91.9		105.0	
Royalties	27.8		62.1		112.0	
Fees and Rentals	30.9		48.0		52.9	
Total	102.8	41.9	202.0	52.7	269.9	37.0
Government of Canada						
Tax Rental and Sharing	58.6		12.5		7.3	
Subsidies	2.4		2.9		3.0	
Total	61.0		15.4	4.0	10.3	1.4
Other Revenue	27.0	11.0	38.9	10.2	124.8	17.1
TOTAL NET GENERAL REVENUE	245.5	100.0	383.1	100.0	729.6	100.0

Note: Totals may not add due to rounding.

[1] Fiscal year ended March 31 of the following year.
[2] Estimated.
[3] Included under Government of Canada — tax rental and sharing.

Source: Budget Bureau, Provincial Treasury Department, Government of Alberta.

Chapter IX

ASSESSMENT OF THE APPARENT WHITE PAPER OBJECTIVES AND PHILOSOPHY

This Chapter begins with a review of the need for tax reform as viewed by the Carter Commission and the White Paper on Tax Reform. The reaction of the Government of Alberta to the White Paper aims of tax reform is then discussed. The Chapter summarizes major apparent differences in economic philosophy between the authors of the White Paper and the Government of Alberta. Chapter IX concludes with our overall recommendations for introducing appropriate tax reform in Canada.

A. THE NEED FOR TAX REFORM

The Government of Alberta recognizes that periodic changes in some aspects of taxation will be necessary in order to provide for social and economic developments in Canada. In this regard, the White Paper referred to the 'serious criticisms' of the existing tax system which were made by the Carter Commission. These criticisms were:

1. The present system does not afford fair treatment for all Canadians. People in essentially similar circumstances do not bear the same taxes, while those in different circumstances do not bear appropriately different tax burdens.

2. Canadians are less well off than they could be because there are fewer goods and services available than could be provided with the more efficient use of labour, capital and natural resources. The present tax system has contributed to this unfortunate result in two ways:

   (a) it needlessly distorts the distribution of productive goods and services; and,

   (b) it fails to compensate where it could for some non-tax barriers to the efficient allocation of productive goods and services.

3. The fiscal system has not been used as effectively as it could have been used to maintain full employment, contain inflationary increases in the price level, and encourage Canadian ownership and control of Canadian industry.

4. In some tax fields, compliance and collection costs have been needlessly raised because of duplicate federal and provincial administrations.

5. Federal tax administration is not sufficiently shielded from political influence and is too centralized for efficiency and convenience.

6. Federal procedures used to obtain and analyze new ideas prior to the introduction of new federal tax legislation are inadequate, as are the procedures for hearing the views of taxpayers and other interested parties in proposed legislation.

7. Federal administration and judicial appeal procedures are deficient and require reforms.

Four of these seven Carter Commission criticisms relate to administrative rather than substantive matters. Our reaction to the first three criticisms is discussed in the summary at the end of this Chapter.

The White Paper also states that: (1) tax can be avoided under the present law by clever devices, and suggests that loopholes are available to those with the wealth and expert advice to use them; and, (2) important forms of income and benefits escape taxation. Some clarification of these points seems necessary.

1. **Tax Avoidance**

Serious loopholes in the present Income Tax Act, which existed at the time of the appointment of the Carter Commission, have been largely eliminated in recent years by decisions in the Courts. In our opinion, the fact that a person has wealth and expert advice should not enable him to avoid legal tax obligations if proper scrutiny is carried out by the Tax Department.

2. **Income and Benefits Which Are Non-Taxable**

This issue really relates to the question of exemptions which are permitted under the present Act as incentives or for other justifiable and legal reasons. To suggest that such income and benefits, which are non-taxable, 'escape' taxation is misleading. This question is dealt with in more detail in the following discussion of the White Paper aims of tax reform.

B. THE AIMS OF TAX REFORM

The following goals and standards guided the authors of the White Paper in their approach to tax reform:

1. a fair distribution of the tax burden;
2. steady economic growth and continuing prosperity;
3. recognition of modern social needs;
4. widespread understanding and compliance with tax laws; and,
5. a system that will be used by the provinces.

1. **A Fair Distribution of the Tax Burden**

The White Paper concept of fairness in taxation implies two principles: (i) people in similar circumstances should carry similar shares of the tax load; and, (ii) people with higher income should be expected to pay in taxes a higher share of their incomes than persons with lower incomes. This concept of 'ability to pay' is embodied mainly in the personal income tax as a progressive graduated tax having increasingly higher rates as income increases.

The basis for this concept seems to stem from the Carter Commission suggestion that society is committed to providing equality of opportunity and improving the well-being of those who have the least economic power. The White Paper objective is to provide tax relief to the lower income segment of our economy by eliminating or reducing their tax burden and increasing the tax burden on others, particularly the middle income taxpayers.

As indicated in our 1967 reply to the Carter Commission Report, the Government of Alberta agrees that society is committed to improving the well-being of Canadians having the least economic power. In our opinion, the best way to strive for long-term and steady improvement in the standard of living of low income Canadians is through implementation of policies designed to maximize economic growth rather than to achieve redistribution of the tax burden. The employment opportunities of most low-income

Canadians should be enhanced if economic activity is maximized. The importance of maintaining economic growth is summarized in the following excerpt from **"A White Paper on Human Resources Development"** which was released by the Government of Alberta in 1967:

> "The supreme objective in developing the physical resources of a nation should be to make possible the full and free development of the human resources of that nation."
>
> "Because physical resources development is absolutely essential to human resources development, the necessity of establishing and maintaining a strong provincial economy cannot be over-emphasized. The development of the physical resources of Alberta to their maximum extent must remain an explicit objective of both government and people."
>
> ". . . Human resources development is absolutely dependent on physical resources development . . . While human resources development demands top priority, the cold hard fact remains that the amount of materials and finances which can be committed to this task are strictly proportional to the level of physical resources development. It is totally unrealistic to be concerned with social development, and at the same time to be unconcerned about economic development. It is totally unrealistic to make demands relative to human resources development without giving consideration to ways and means of stimulating the increases in physical resources development required to make humanitarian proposals physically possible and economically feasible."

The White Paper authors apparently assumed that new capital investment, economic activity, and tax revenues will be roughly the same if its proposals are implemented as they would be under continuation of the present tax structure. As pointed out in earlier Chapters of this brief, we believe that implementation of the White Paper proposals will reduce new capital investment in Alberta and elsewhere in Canada and, as a consequence, economic activity will be impaired and government revenues reduced.

Many knowledgeable and respected Canadians have expressed concern that investment of both foreign and domestic capital will be discouraged under the proposed White Paper taxation system. In fact, the White Paper admits that under its system new investment in the mineral industries and closely-held companies would be reduced. This prospective development seems to conflict with the following policies of the Economic Council of Canada.[1]

> "The preceding discussion by no means exhausts the considerations affecting Canada's policies for achieving high, sustained and balanced growth. In the course of our analysis, certain other problems have emerged that will have to be borne in mind by decision-makers to the mid-1970's:
>
> — Achievement of Canada's potential to 1975 will require a high rate of public and private investment. Accordingly, careful attention will be required to the maintenance of a high rate of national saving, as well as to the retention of good access to saving from non-residents. Policies will need to be examined closely for their ultimate impact on savings."

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[1] Sixth Annual Review of the Economic Council of Canada, "Perspective 1975", page 164.

The Government of Alberta and the Federal Government would like to see a greater degree of participation by Canadian investment capital in the development of our resources. However, we recognize that prospective investors must be given tangible tax incentives to compensate for investment of their savings in high-risk natural resource industries. The White Paper concept of fairness or equity does not recognize that a tax system must provide incentives or rewards for risk-taking if it is to be truly fair and if it is to bring forth the required level of investment capital. In other words, fairness means taxation of unequals at different effective rates, so as to give incentives to those who are prepared to make investments in high-risk ventures.

Because so much of our Alberta economy is directly or indirectly dependent on relatively-high-risk natural resource developments, we are deeply concerned that the White Paper definition of fairness and equity in taxation does not recognize risk.[2] The obvious effect of implementation of tax proposals based on its philosophy will be the diversion of new investment capital to other countries.

For example, the proposed capital gains tax based on full marginal rates of the individual taxpayer, coupled with the adverse impact of the revised estate tax legislation, will discourage Canadians from investing in such vital Canadian industries. This is particularly true since such industries are financed largely from reinvestment of earnings, and their prospective capital gains are more important to investors than dividends. If we want to encourage Canadians to invest to a greater degree in the ownership of our industries, we must offer them realistic investment incentives. It is that simple. The fact that the authors of the White Paper are unable to comprehend this elementary investment criterion is puzzling. In the interest of all Albertans who would be adversely affected under the White Paper system, we are obliged to speak frankly. In our opinion, senior civil servants, and politicians responsible for drafting or approving the White Paper obviously have had very little, if any, personal involvement in the day-to-day operations of enterprises making up our economy. By involvement, we mean personal commitments to meet payrolls or debt obligations, many of which are secured by personal guarantees or collateral in the form of personal assets. Nor do they really appreciate the direct and indirect employment opportunities provided by such enterprises.

An individual who has personally experienced or observed one or more of the following situations could not, in all sincerity, recommend a capital gains tax tied to marginal rates, particularly in view of the punitive nature of the amended estate and gift tax legislation:

(a) building of a farm or ranch over a long period of years which has required reinvestment of profits in order to (i) provide for acquisition of additional land and equipment to maintain an economic unit in the face of rising costs, (ii) periodic crop failures due to frost, hail, et cetera, (iii) poor market conditions despite bumper crops which cannot be converted to cash, and, (iv) loss of spring calves due to late snow conditions. Gains on the sale of such operations are largely a result of inflation;

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[2] In the interest of brevity, the unique risks facing the petroleum industry in particular will not be dealt with in this brief. In this regard, we refer the reader to our reply to the Carter Commission entitled: "Submission by the Government of the Province of Alberta Concerning the Report of the Royal Commission on Taxation", December 1967. This subject has also been discussed in detail in other briefs to the Carter Commission and in reply to the Carter Reports.

(b) building of an oilwell drilling company in the face of (i) attractive drilling plays which cannot utilize the capacity of that company's equipment, and, (ii) expensive 'fishing' costs or other delays which must be absorbed by the driller.

(c) building an independent oil company from scratch which poses unusual and difficult financing problems and which may be accentuated by a series of poor exploration results.

(d) building a specialized trucking business for oil and gas well servicing or to meet the needs of the construction industry. In many cases, there are no alternative uses for such specialized equipment and, therefore, such businesses are totally dependent on the viability of the industries they serve; and,

(e) building of tourist and recreational services, most of which are located in non-urban areas, which, in addition to being affected by uncontrollable factors such as weather conditions, are largely dependent on the overall viability of the provincial or regional economy.

These examples are typical and real. The White Paper is a very impersonal attempt to develop a utopian taxation system but it ignores the human as well as the economic problems which it will create.

2. Steady Economic Growth and Continuing Prosperity

Alberta is interested in maintaining and even increasing the economic strength of Canada. However, we do not feel that this can be achieved by weakening the economic structure of one or more of the stronger provinces. As shown in Chapters VI and VIII, this will be the result if the White Paper proposals relating to the mineral industries are implemented.

We have seen no evidence in the White Paper, or in public responses to the Paper, to satisfy us that certain of the major White Paper proposals will have a favourable effect on the Canadian economy and, therefore, on the well-being of all Canadians. In fact, to the contrary, the White Paper admits that investment in mineral industries will be reduced under its system, and warns about the hazards of economic forecasting, particularly when major changes are proposed in the tax structure.

We have commented at length on its impact on petroleum and agriculture. In regard to agriculture, however, the proposed tax system would destroy the capital base of many of our present farm families, as a result of the double-barrelled effect of a combined capital gains tax and estate tax amendments, and could lead to increased ownership by non-Canadians of all larger and progressive farm and ranch units. Such an inevitable transfer of ownership to non-Canadians conflicts with Federal Government objectives to increase Canadian ownership and with the expectations of the White Paper as laid down in paragraph 1.5.

3. Recognition of Modern Social Needs

Paragraph 1.13 points out that our increasingly urban society imposes upon governments and other public authorities demands and conditions which strain to the limit their ability to finance and to execute their activities, and that the reformed income tax must further the proper development of this changing society. Also, in paragraph 1.3, the White Paper states that:

"The needs of the federal and provincial governments for money to do useful and important things are so great that we cannot now afford to reduce the over-all revenues from personal and corporate income tax."

The Government of Alberta cannot support the introduction of a completely new tax system which will generate incremental revenues for new social programs which have not been identified by the Federal Government nor approved by the Canadian public or by the ten provincial governments.

It is obvious that the White Paper is more than tax reform exclusively designed to eliminate or reduce tax avoidance or evasion, and to approach true equity and effective neutrality. The White Paper is also a revenue-producing proposal of significant proportions which will create a much larger burden of taxation not only for existing taxpayers but for those who have not yet entered the labour force. It is unfair to commit this latter group in particular to such an onerous future tax burden. The White Paper estimates a $630 million increase in revenues in the fifth year of operation under its proposed system. The Ontario Government estimates increases in the order of $1.3 billion in the fifth year, using the White Paper assumptions about the Canadian economy.

The effect of these increased federal government taxes will be a further shift in resources from the private to the public sector. The Economic Council of Canada Sixth Annual Review pointed out in pages 25 and 26:

"Our estimates involve some increase in the relative size of the government sector of the economy, implying a combination of the shift from private to collective consumption of goods and services . . . The economy's capacity to provide the resources to satisfy expanding needs — either private or government — is not unlimited."

The present Minister of Finance expressed his concern about the size of the public sector in his maiden speech in the House of Commons on October 23, 1962 when he stated:

"Mr. Chairman, I indicated earlier the importance of taxation in our national economy when I indicated that 32.3 per cent of the gross national product is now being collected and redistributed through taxation by governments at all levels. In 1960 this government drained off 17.5 per cent of the gross national product for the operation of the federal government and redirection according to what they thought would best serve the national interests."

The Economic Council of Canada Sixth Annual Report has indicated that the public sector share would increase to 37 per cent in 1975, presumably under a continuation of the present taxation system.

We, like others, are concerned about the increasing level of taxation and increasing trend towards centralization of the economy with the Federal Government. As expressed in our 1967 reply to the Carter Report:

"Consideration must also be given to the degree of taxation that can realistically be imposed without significantly inhibiting economic growth. We may be dangerously near this level now. If this is so, the alternative becomes one of establishing priorities for government expenditures."

Personal income tax is given priority in the White Paper Tax Reform Program. In aggregate, much of the cost must be borne by those at the

upper end of the $5,000 to $10,000 range. This position by the White Paper assumes that all the revenues to be generated under its system are necessary.

Before introducing a new personal tax structure which will put increased tax pressure on any single group of taxpayers, the government must examine its revenue estimates in more detail. If the estimated revenues prove significantly higher than necessary, then the tax proposals, including tax rates, will have to be revised and, in this way, avoid the need to put increased pressure on any one or more income tax groups.

As part of new Federal Government proposed social programs, sources of revenue should be detailed. Only in this way can the voter decide if he wishes to be burdened with additional taxes necessary to support such programs.

4. **Widespread Understanding and Compliance with Tax Laws**

The Government of Alberta supports this White Paper objective. However, we would be interested in knowing the identity and nature of specific loopholes referred to in paragraph 1.14 and elsewhere in the White Paper. Paragraph 1.24 deals with simplification of the present personal income tax structure. However, simplification could be achieved without designing a totally new tax act. Also, some of the proposals, such as 'valuation day', deemed realizations and the income-averaging formula, would work against this objective.

5. **A System That Will Be Used By The Provinces**

Alberta agrees that harmony in federal and provincial policies and practices is desirable, and that much has been accomplished in this respect.

As mentioned earlier, Alberta is prepared to co-operate in development of reasonable tax reform measures. However, we are not prepared to support the introduction of theoretical and untested major tax measures which could cause a serious disruption of the economy on a regional or national basis. Also, if tax reform measures have the effect of increasing tax revenues, then the provinces must participate to a major degree in such increases.

C. DIFFERENCES BETWEEN THE PHILOSOPHY AND POLICIES OF THE WHITE PAPER AND THE GOVERNMENT OF ALBERTA

Many of the apparent differences in philosophy between the authors of the White Paper and the Alberta Government have been illustrated earlier in this Chapter. For example, reference was made to the substantial increase in Federal Government revenues which will develop under the proposed tax system of the White Paper. We have already expressed sincere concern about the implied increasing importance of the federal public sector and the adverse impact that such a level of taxation could have on economic growth. It is important to maintain a strong rate of growth if we are to meet overall employment objectives in Canada.

As indicated in our 1967 brief in reply to the Carter Report:

> "Any future changes in government policies and regulations should be directed at achieving an objective balance between economic growth and the expenditure programs required by various levels of government to fulfill their responsibilities."

In this regard, we are deeply concerned that the Federal Government has not been more explicit regarding new social programs which would require such enormous amounts of additional revenues. The Federal Government has expressed a desire to increase Canadian ownership of our economy. If the Federal Government means ownership by the private sector, we support them. However, in view of its apparent intention to increase the relative importance of the public sector, we wonder if the Federal Government is proposing increased Canadian ownership through Federal Government vehicles rather than through private enterprise. We would not support such a policy. A precise statement of position in this regard on the part of the Federal Government is needed. The Government of Alberta maintains its traditional policy that Canadian ownership should be encouraged through private enterprise. Obviously, this can only be achieved through a taxation policy which encourages rather than discourages Canadian ownership. The Government of Alberta does not support state control of our economic development.

The authors of the White Paper seem to have been motivated by an obsession to discourage personal savings, to destroy any incentive for citizens to build a capital base for themselves or their heirs, and to discourage individuals from providing for their financial needs upon retirement. For example, in paragraph 2.46 dealing with pensions and retirement savings plans, the White Paper states that:

> "With 40 years of saving, say from age 25 to 65, it is possible to double the after-tax retirement income. This is a valuable tax concession to persons able to take advantage of it."

In our opinion, this is not a concession. It is an incentive to encourage taxpayers to provide for their own retirement needs. Without such incentives, a greater degree of responsibility would fall on governments to carry the burden of looking after retired citizens. Stated another way, to an increasing degree, our children would be faced with the burden of looking after our retirement. Under the present system, a taxpayer can design a retirement program to fit his specific needs. If the burden is centralized in Federal Government hands, this freedom of choice or flexibility will be reduced or lost.

As expressed elsewhere, we cannot support many of the major reform proposals because they will represent a further centralization of economic activity in Canada to the Federal Government. For example, both the proposed changes in taxation of the petroleum industry and the proposal to tax capital gains at marginal rates would have this effect.

Alberta is also sincerely concerned about the apparent inflexible position of the Federal Government in connection with the White Paper, irrespective of its frequent reference to the fact that they represent only proposals. For example, in a speech to the Canadian Tax Foundation in March 1970, the former Deputy Minister of Finance stated:

> "Last night I met with a number of the officials of the Department who have been here and attended sessions Monday and Tuesday while I was tied up in Ottawa. What they have reported to me indicates that from the point of view of the Department, the analyses, the comments and the suggestions are going to be valuable. But they also indicate so far we have not yet succeeded in getting all our ideas across clearly and persuasively. For example, we remain convinced,

despite all the discussion, that there is still a valued distinction between closely-held and widely-held corporations and that it is a useful distinction to make for tax purposes. Clearly, many of you are still unconvinced that such is the case and we shall seek opportunities to present more convincing explanations of our views and of the rationale for the proposals. Meanwhile, we are benefiting, and hope to benefit further, from detailed comments made here and elsewhere on drawing the boundary lines between these two categories."

This statement seems to suggest that those responsible for the White Paper are unprepared to seriously entertain changes in major White Paper proposals despite sincere comments made in public or in briefs presented to the Department or Government Committees by responsible Canadians.

D. SUMMARY

The Government of Alberta recognizes that tax reforms must be introduced from time to time in order to take into account the dynamic nature of our society. However, we do not believe that the introduction of the basic new tax system as proposed in the White Paper is either advisable or necessary. We have already indicated those proposals which we support and those which we do not support. Unfortunately, because many of the major proposals are inter-dependent, removal or changes affect the whole White Paper package. This, of course, is one of the major weaknesses of the White Paper. The architects of this document should have anticipated that some of their proposals would prove unworkable. It is evident that the White Paper is unacceptable as a package.

At the same time, it would be imprudent to send the White Paper 'back to the drawing board' and have the same or similarly-inclined authors revise it. This approach could take another two to three years, which is not advisable in view of the lengthy period of uncertainty which has faced investors and taxpayers in Canada for nearly a decade.

Clearly, there is only one appropriate alternative. The Present Act should be retained. Appropriate changes should be made from time to time. In arriving at such revisions, consideration should be given to new social programs approved by the Canadian public and whether their costs can be met from normal government revenues. If not, a list of priorities must be devised and consideration should be given to elimination of those existing social programs which are obsolete or unnecessary.

We have expressed concern that the authors of the White Paper, and indeed many of their predecessors who drafted the Royal Commission on Taxation Report had little practical experience with the various industrial and commercial components of our economy and more particularly in the factors which contribute to the viability of regional growth. For this reason, we adhere to the major recommendation made in our 1967 Submission in response to the Carter Report. In that submission we stated:

"We would like to make a recommendation concerning procedures for changing our existing Income Tax Act. Changes affect all personal and corporate taxpayers and all levels of government in Canada. Therefore, we feel that before tax proposals are submitted to Parliament they should be reviewed by a truly representative body of experts including recognized Canadian tax authorities from the legal and accounting professions, from industry, commerce, trade unions and

all levels of government. . . . Adoption of this recommendation should assure that proposed changes in the Act are appropriate to Canada's national and regional requirements."

In addition to our belief that many of the major White Paper proposals are not in the best interests of Canadians, we are also concerned that other major revisions may be introduced at a later date, such as the family unit concept, changes in depreciation rates, et cetera. This makes it impossible to accept the present reform package. It is also unfortunate that certain statements in the White Paper are misleading to the casual reader; for example, reference to 'stumbling across a mine' and substantial real estate or stock market gains, which in our opinion are the exception rather than the rule.

We do not believe that wholesale rewriting of the present Act is necessary or advisable. The Royal Commission on Taxation (Volume 1, page 2) recognized that the present system is a good one. Many tax authorities have pointed out that those acceptable White Paper proposals could be introduced within the framework of the Present Act, and have pointed out that complete replacement of the existing Act would eliminate over twenty years of legal precedence.

The Federal Government has made an irrevocable commitment to the Canadian people to give them the opportunity, without constraints, to be heard on the White Paper (1.1). They must be given this opportunity before the House of Commons and Senate Committees, irrespective of the length of such proceedings.

The Government of Alberta is prepared to support gradual introduction of reasonable tax reform measures. However, it is not prepared to accept the replacement of the existing Act with totally new and untested tax reform measures. It would be irresponsible to support the latter approach when its impact on the Canadian economy and therefore on the welfare of each Canadian citizen is unknown and cannot be measured with a reasonable degree of reliability.

PART 3

ALBERTA'S POSITION

CONCERNING RECENT REVISIONS

TO THE WHITE PAPER

"PROPOSALS FOR TAX REFORM"

SEPTEMBER, 1970

The Position of the Government of the Province of Alberta Concerning Proposed Revisions to the White Paper 'Proposals for Tax Reform'

Introduction

On August 26, 1970, Finance Minister E. J. Benson sent a letter to the provincial finance ministers outlining three revisions to the White Paper 'Proposals For Tax Reform'.[1] The revisions concern taxation of the Canadian mining industry.

One purpose of this position paper is to comment on these three proposed revisions which were prompted by present uncertainty in the mining industry. A more important purpose, however, is to express our grave concern that the proposed revisions relate only to the Canadian mining industry. In proposing these revisions, the Department of Finance has ignored the other major segment of the Canadian minerals industry – petroleum exploration and development – which, in our opinion, faces equal or greater uncertainty than the mining segment. Because the petroleum industry is so important to the Alberta economy and to the fiscal capacity of the Government of Alberta, this serious matter must be fully discussed with the Minister of Finance.

The Revisions Involving Taxation of the Canadian Mining Industry

The three revisions to the White Paper 'Proposals For Tax Reform', which involve taxation of the Canadian mining industry, may be summarized as follows.

1. The White Paper definition of expenditures which would qualify for the 'earned' depletion allowance would be widened to include in the base for earned depletion the costs of new facilities located in Canada to process mineral ores to the prime metal stage or its equivalent.

2. Expenditures that earn depletion would be widened to include mine buildings, and machinery and equipment acquired in connection with a major expansion of an existing Canadian mine, thereby putting major expansion of an existing mine on a roughly comparable tax footing with the opening of a new mine.

3. Increased Federal Government abatement would be available to the provincial governments for corporate taxes on taxable production profits from a mine. The Federal Government maintains that this particular revision would give provincial governments the opportunity to bring the taxation of mining profits into line with taxation of profits in other industries, and, if the provinces wish, to exercise discretion in the application of their mining taxes.

Specifically, once the transitional period of automatic depletion ends, the federal abatement for corporate taxes on taxable production profits from a mine would be increased to 25 percentage points from 10 percentage points and the deduction as an expense from taxable income of provincial mining taxes would be ended. In other words, the effective rate of federal taxes would be reduced to 25 per cent from 40 per cent, but this tax (and the corporate tax of those provinces that have entered into collection agreements with the

[1] Concurrently, the Department of Finance issued News Release 70-105 which further commented on these proposed revisions.

Federal Government) would be applied against the taxable mining profits before deducting provincial mining taxes, thereby automatically increasing provincial revenues because the provincial corporation tax would then be applied against taxable income that had not been reduced by a deduction for provincial mining taxes.

This third revision apparently stemmed from the fact that under the proposed White Paper system, when the provincial mining taxes are taken into account, the maximum tax rate on the taxable income from producing mines could be significantly higher than the rate on the taxable income of corporations in most other industries. It was contended that in some sectors of the mining industry there would be insufficient earned depletion, under normal conditions, to bring the effective tax rate down to the rate that applied to other industries.

It will be recalled that after the Carter Report was issued in 1967, the Federal Government subsequently had to make assurances that provisions in effect at that time would remain so until 1974, in order that conventional mining activity would not be seriously reduced. In spite of that acknowledgment, the White Paper subsequently came out with proposals supporting income tax rates paid by the mining industry which would increase from 44.5 per cent to 59.2 per cent. We cannot understand how the Federal Government could make such a proposal in 1969 after their 1967 experience.

The above figures of 44.5 per cent and 59.2 per cent are quoted from the August 26, 1970 letter from the Minister of Finance to provincial finance ministers and treasurers. In the Department of Finance News Release 70-105, it was further pointed out that the comparable tax rate based on the suggested revisions described above will be 52.0 per cent. Therefore, while the revisions reduce the tax from the White Paper proposals by 7.2 percentage points, the rate based on the revisions is still 7.5 percentage points above the rate under the Existing Act. Although the proposed revisions suggest that the Federal Government is retreating from its White Paper for taxation of the mining industry, the above figures clearly show that the conventional Canadian mining industry will be left in a worse position under the revised White Paper proposals than under existing tax laws.

As you know, the existing Great Canadian Oil Sands Limited (GCOS) development and the Syncrude Canada Limited project (if it goes forward) will be of long-term significance, particularly in relatively undeveloped areas of Alberta. The $250-million GCOS operation was developed under the existing Income Tax Act. Implementation of the White Paper proposals would materially change the economics upon which that project was developed, particularly since GCOS would not benefit from the 'earned depletion' benefit. The revisions now proposed by the Minister of Finance would not offset the adverse and retroactive impact on GCOS of the White Paper taxation system, if implemented.

Implementation of the White Paper system would almost certainly result in cancellation of the $200-million Syncrude proposal, due to the proposed removal of the three-year mining exemption and the changes in the depletion allowances. The latter would be of little benefit to the costly and high-risk tar sands development which, by the nature of their operation, are not involved in ongoing exploration. The proposed revisions for taxation of the mining industry would do very little to reinstate that project.

Implementation of tax laws which cause postponement or cancellation

of such important projects seem inconsistent with the objective outlined in the August 26, 1970 letter from the Minister of Finance, namely:

> "Uncertainty on this subject may be causing the postponement of important projects, particularly in some of the slow-growth regions where the federal and provincial governments are attempting to spur economic activity through other programs."

The third revision in itself is of little significance to Alberta because there is very little in the way of corporate taxes from conventional mining carried out within the Province and, furthermore, unlike some other provinces, Alberta does not levy a tax on mining profits. While we generally welcome any situations whereby provinces have a better share of overall tax revenue in Canada, we are concerned that these revisions are being proposed merely to shift an undesirable situation from Federal to provincial government shoulders.

The August 26 letter from the Minister of Finance pointed out that implementation of the third revision would require an amendment to the White Paper integration proposal, as indicated by the following excerpt from that letter:

> "The reduction in the federal rate would require an amendment to the integration proposals, because full integration could not be extended to closely-held mining corporations if the federal government retains only 25 points of tax. We believe that the most natural amendment would be to treat all Canadian mining corporations as widely-held corporations — that is, to give Canadian shareholders credit for 25 percentage points of the corporation taxes paid by the corporation on the profits from which the dividends were paid. Many mining corporations would already receive this treatment under the White paper proposals."

The White Paper integration proposals appear at first glance to be beneficial. However, the more that one studies the resulting side effects caused by implementation of the integration theory, the more one realizes that this first appearance is misleading. Time and again the integration theory creates unfavorable end results. This fact was acknowledged to some extent in the White Paper in regard to public utilities (sections 4.63 to 4.65). It has been acknowledged further by the complicated set of rules set forth by the Minister of Finance in News Release 70-34 dated March 19, 1970.

In addition, analysis of the proposals show that the shareholders of pipeline, mining, petroleum, and other companies can be unjustly affected. To the extent that any incentive allowances for development of these types of companies are given, the integration proposals prevent the benefits of such allowances from being passed on to the shareholders. If we wish to have Canadians invest in Canadian companies, then obviously incentives given for various purposes must eventually reach the person who provides the capital and who takes the risk. (This matter is discussed in considerable detail in our June 1970 Submission, section IV. In the interest of brevity, it has not been repeated in this position paper.)

Another facet of the White Paper integration proposals was the artificial concept of widely-held and closely-held corporations. The above quotation from Mr. Benson's August 26, 1970 letter states that, if the third revision is implemented, it will require designation of all mining companies as widely-held corporations. We believe this will further aggravate an already artificial situation.

The White Paper Proposals and the Canadian Economy

Our submissions to the Federal Government in response to the Carter

Report and more recently in response to the White Paper 'Proposals for Tax Reform' emphasize the importance of a viable petroleum industry to the Canadian economy in general, and to those provinces in which oil and natural gas production is, or may be, significant. It is not our intention to comment further on this important subject in our present position paper. However, we feel obligated to comment on one matter covered in those earlier submissions, which was referred to in News Release 70-105.

That News Release refers to special rules which "have been applied in determining the income derived from mining", and that "special rules are still needed for the mineral industry". The Release further states that the White Paper on tax reform proposed to substantially revise these rules "to ensure that really profitable projects pay a fair share of the national revenues, as other industries do, and that the inducements offered are efficient."

These statements imply that the mineral industries do not carry their fair share of the total tax burden. It seems as though the Federal Government is speaking of contribution to national revenues in the narrowest sense – that is, corporate taxes paid. As pointed out in our June 1970 Submission (Page VIII-3), when consideration is given to all forms of governmental revenues, it is evident that the petroleum industry makes a very substantial contribution to overall government revenues.

The August 26, 1970 letter from the Minister of Finance pointed out that a number of provinces regard as urgent the subject of tax treatment of the mining industry. As set forth in that letter:

> "Uncertainty on this subject may be causing the postponement of important projects, particularly in some of the slow-growth regions where the federal and provincial governments are attempting to spur economic activity through other programs."

The Government of Alberta appreciates the urgency which is attached to resolving this uncertainty facing both mining companies and those provinces in which the conventional mining industry is important. We therefore support reasonable taxation policies which will maintain "an efficient stimulus to development of the Canadian mining industry" (to quote from the last page of Mr. Benson's letter).

It would appear that the Minister of Finance is now prepared to recognize uncertainty in the mining industry but not uncertainty in the Canadian petroleum industry. Submissions by the Government of Alberta and by various segments of the petroleum industry in response to the White Paper proposals (plus testimony given before the recently-concluded Parliamentary Committee hearings on tax reform) expressed sincere concern about the uncertainty created by the White Paper proposals for investors in the Canadian Petroleum industry. Indeed, certain oil producers have publicly indicated specific amounts of investment capital which have been lost as a result of the White Paper proposals. For example, in testimony before the Standing Senate Committee on Banking, Trade & Commerce, an officer of Bow Valley Industries Ltd. stated

> "In the case of Bow Valley Industries we have had an average of $3 million a year from outside investment. On November 7, the day after the White Paper proposals were published, those funds were cancelled and we did not get another dollar and will not until this problem is resolved."

Two key points seem to come out of the statement concerning uncertainty in the Minister of Finance's letter.

Mr. H. C. Van Rensselaer, Vice President, Finance, Bow Valley Industries Ltd. (see page 36:34, Thirtieth Proceedings on the Government White Paper).

1. The minister of Finance now seems to recognize the importance of investment capital in stimulating economic activity in slow-growth regions, and the role of government policies – including taxation policies – in reaching this objective.

The Government of Alberta – in its submissions in response to the Carter Commission and the White Paper – *stressed* that the best way to strive for long-term and steady improvement in the standard of living of low income Canadians (many of whom reside in slow-growth areas) is through implementation of policies designed to maximize economic growth rather than through redistribution of the tax burden as recommended both by Carter and the White Paper.

The reference in the August 26 letter that White Paper proposals are causing the postponement of important projects suggests that the Federal Government is beginning to accept our 'economic growth' approach to improving the overall welfare of Canadians.

2. We support introduction of carefully studied, practical taxation and other policies designed to 'spur' economic activity in slow-growth regions of Canada. At the same time, we must not create taxation policies or prolong uncertainty as to possible radical taxation measures which will discourage capital investment in the high-growth regions of Canada. In our opinion, this is exactly what the Federal Government has done through many of its proposed White Paper measures for taxation.

As indicated in our more recent brief, Alberta is interested not only in maintaining but increasing the economic strength of Canada. However, we do not feel this can be achieved by weakening the economic structure of one or more of the stronger provinces. Creation of a depressed area as a result of undesirable tax legislation could only result in a greater financial burden on Canadian corporate and individual taxpayers.

Continued investment in the Canadian petroleum industry must be encouraged if economic growth is to be maintained. Only in this way will we be able to contribute to providing job opportunities for our growing labor force.

In this regard, we wish to reiterate a very important point referred to in our earlier submissions which apparently is not properly understood. Uncommitted domestic and foreign investment capital is mobile and, assuming tax policy to be known and stable, available capital will flow to domestic or foreign areas where they can be employed most profitably relative to the risks involved. Therefore, unless Canada provides competitive tax incentives, sufficient investment capital will not be forthcoming and necessary oil and gas reserves will not be developed over the long term to supply prospective markets. Also, without such investment, the financial position of the Province of Alberta will be seriously impaired. These subjects were discussed in some detail in our June 1970 Submission in response to the White Paper. The revisions to the White Paper now proposed for the mining industry do not remove the weaknesses of 'earned depletion' as it relates to the petroleum industry. These weaknesses are discussed on pages VIII-4 and VIII-5 of our submission in response to the White Paper.

The Government of Alberta is also concerned about the revised timetable now predicted by the Minister of Finance for implementation of amendments to the Income Tax Act. The need to amend the White Paper integration proposals, if these revisions are made, confirms our earlier contention (see

page 1-6 of our June Submission) that many of the major White Paper proposals are interdependent and that it is impossible to make changes without disrupting the whole White Paper 'package' concept. Other practical problems associated with the White Paper reform proposals will undoubtedly arise after further study. If each problem requires changes in other White Paper proposals, the period of uncertainty could be extended materially.

For this and other reasons, the revised time schedule seems overly optimistic. As pointed out in the August 26 letter, the parliamentary committee reports have not been released. Certainly the Government of Alberta will wish to review these reports carefully and will want to make our views known to the Minister of Finance before amendments to the Income Tax Act are submitted to the House of Commons and Senate. Regarding the suggestion that amendments to provincial tax legislation will need to be made prior to 1972, may we point out that the Alberta and other provincial legislatures normally meet in late winter and early spring. The prolonged uncertainty implied in this revised time schedule supports our view that, in the interest of all Canadians, the White Paper should be dropped in favor of an immediate start on gradual streamlining of our existing Act.

Finally, the August 26 letter from the Minister of Finance suggests that these three revisions:

> "taken together with the substantial incentives already proposed in the White Paper will enable the federal and provincial governments to co-operate in maintaining an efficient stimulus to development of the Canadian mining industry in the future."

With all due respect the Government of Alberta submits that a proper spirit of cooperation, which is both desirable and necessary, will not be achieved unless the Federal Government recognizes, by immediate major revisions to the White Paper, the valid position which individual provinces have taken with respect to the White Paper 'Proposals For Tax Reform'. We feel that the position we have taken in regard to the White Paper proposals is in the best interest of the Canadian economy.

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